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ESTABLISHMENT OF A WAR FINANCE CORPORATION

HEARINGS

BEFORE THE

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COMMITTEE ON FINANCE
UNITED STATES SENATE

SIXTY-FIFTH CONGRESS

SECOND SESSION

ON

S. 3714

A BILL TO PROVIDE FURTHER FOR THE NATIONAL SECURITY AND DEFENSE, AND, FOR THE PURPOSE OF ASSISTING IN THE PROSECUTION OF THE WAR, TO PROVIDE CREDITS FOR INDUSTRIES AND ENTERPRISES IN THE UNITED STATES NECESSARY OR CONTRIBUTORY TO THE PROSECUTION OF THE WAR, AND FOR OTHER PURPOSES

Printed for the use of the Committee on Finance

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ESTABLISHMENT OF A WAR FINANCE CORPORATION.

FRIDAY, FEBRUARY 8, 1918.

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
WASHINGTON, D. C.

The committee met, pursuant to call, at 10.30 o'clock a. m., in the committee room, Capitol, Senator F. M. Simmons presiding.

Present: Senators Simmons (chairman), Stone, Smith of Georgia, Thomas, James, Gore, Jones of New Mexico, Gerry, Penrose, Lodge, McCumber, Smoot, Gallinger, and Townsend.

Present also: Hon. W. G. McAdoo, Secretary of the Treasury, Hon. William P. Harding, Governor Federal Reserve Board, and Hon. Paul M. Warburg, Vice Governor Federal Reserve Board.

The CHAIRMAN. The committee will please come to order. Gentlemen of the committee, I have called this meeting that we might have the privilege of hearing the Secretary of the Treasury give the committee his views as to legislation contained in Senate bill No. 3714, providing for the establishment of a War Finance Corporation, which is as follows:

[S. 3714, Sixty-fifth Congress, second session.]

A BILL To provide further for the national security and defense, and, for the purpose of assisting in the prosecution of the war, to provide credits for industries and enterprises in the United States necessary or contributory to the prosecution of the war, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That for the purpose of affording financial assistance, either directly or indirectly, to persons, firms, corporations, and associations whose operations are necessary or contributory to the prosecution of the war, in cases where such persons, firms, corporations, or associations shall be unable to procure funds on reasonable or practicable terms from the general public, or through the regular banking channels, and for the purpose of regulating and controlling the sale and offering for sale or subscription of securities hereafter issued, and for other purposes in aid of the prosecution of the war, the Secretary of the Treasury, together with four additional persons (who shall be the directors first appointed as hereinafter provided) are hereby created a body corporate and politic in deed and in law by the name, style, and title of the "War Finance Corporation" (herein called the Corporation), and shall have succession for a period of ten years, provided that in no event shall the corporation exercise any of the powers conferred by this act, except such as are incidental to the successful liquidation of its assets and the successful winding up its affairs after six months after the termination of the war, the date of such termination to be fixed by proclamation of the President of the United States.

SEC. 2. That the capital stock of the corporation shall be $500,000,000, all of which shall be subscribed by the United States of America, and such subscription shall, upon the approval of the Secretary of the Treasury, be subject to call upon the vote of three-fifths of the board of directors of the corporation at such time or times as may be deemed advisable; and there is hereby appropriated, out of any money in the Treasury not otherwise appropriated, the sum of

$500,000,000, or so much thereof as may be necessary for the purpose of making payment upon such subscription when and as called. Receipts for payments by the United States of America for or on account of such stock shall be issued by the corporation to the Secretary of the Treasury and shall be evidence of stock ownership.

SEC. 3. That the management of the corporation shall be vested in a board of directors consisting of the Secretary of the Treasury, who shall be chairman of the board, and four other persons, to be appointed by the Secretary of the Treasury, with the approval of the President of the United States. Any director or directors so appointed may be removed by the Secretary of the Treasury, with the approval of the President, and vacancies, however arising, may be filled by the Secretary of the Treasury, with the approval of the President. Whenever a vacancy shall occur among the directors so appointed, the person appointed director to fill any such vacancy shall hold office for the unexpired term of the member whose place he is selected to fill. Three members of the board of directors shall constitute a quorum for the transaction of business.

SEC. 4. That the principal office of the corporation shall be located in the District of Columbia, but there may be established agencies or branch offices in any city or cities of the United States under rules and regulations prescribed by the board of directors, with the approval of the Secretary of the Treasury.

SEC. 5. That the four directors of the corporation appointed as hereinbefore provided shall devote their entire time to the business of the corporation (except such part of their time, if any, as shall be devoted to other governmental business) and shall receive annual salaries, payable monthly, the amount of which shall be fixed by the Secretary of the Treasury, with the approval of the President of the United States, not, however, exceeding the annual salary of the principal officer of an executive department of the United States. Any director receiving from the United States any salary or compensation for services shall not receive as salary from the corporation any amount which, together with any salary or compensation received from the United States, would make the total amount paid to him by the United States and by the corporation exceed the amount fixed as the annual salary of a director of the corporation, as hereinbefore provided. Of the four directors appointed, as hereinbefore provided, the Secretary of the Treasury shall designate two to serve for two years, and two for four years; and thereafter each director so appointed shall serve for a term of four years. No director or officer of the corporation shall continue to be an officer, director, or trustee of any other corporation or member of any firm of bankers; and, before entering upon his duties, each director and officer shall certify under oath to the Secretary of the Treasury that he has complied with this requirement, and shall also take an oath faithfully to discharge the duties of his office. But nothing contained in this act or in the Federal reserve act shall be construed to prevent the appointment of a member of the Federal Reserve Board or of any other governmental administrative body or of a director of a Federal reserve bank as a director of the corporation.

SEC. 6. That the corporation shall be empowered and authorized—

(a) To adopt, alter, and use a corporate seal; to make contract; to purchase or lease and hold or dispose of such real estate as may be necessary for the prosecution of its business; to sue and be sued; complain and defend in any court of law or equity, including courts of the United States; to appoint, by its board of directors, and fix the compensation of such officers, employees, attorneys, and agents as are not otherwise provided for in this act, to define their duties, require bonds of them and fix the penalties thereof, and to dismiss at pleasure such officers, employees, attorneys, and agents; and to prescribe, amend, and repeal, by its board of directors, subject to the approval of the Secretary of the Treasury, by-laws regulating the manner in which its general business may be conducted and the privileges granted to it by law may be exercised and enjoyed, and prescribing the powers and duties of its officers and agents.

(b) To make advances, upon such terms not inconsistent herewith, as it may prescribe for periods not exceeding five years from the respective dates of such advances, (1) to any bank, banker, or trust company which has made, and which has outstanding, any loan or loans to any person, firm, corporation, or association whose operations shall be necessary or contributory to the prosecution of the war and evidenced by a note or notes, or (2) to any bank, banker, or trust company which has rendered financial assistance, directly or indirectly, to any such person, firm, corporation, or association by the purchase

of its bonds or other obligations: *Provided*, That advances so made by the corporation on the basis of any such loan or loans shall not exceed seventy-five per centum of the face value thereof: *And provided*, That any advances so made by the corporation, in cases where such financial assistance shall have been rendered by the purchase of such bonds or other obligations, shall not exceed seventy-five per centum of the market value of such bonds or other obligations at the time of such advance, as estimated and determined by the board of directors of the corporation: *And provided further*, That all such advances shall be made upon the promissory note or notes of such bank, banker, or trust company, secured by the notes, bonds, or other obligations, which are the basis of any such advance by the corporation, together with all the securities, if any, which such bank, banker, or trust company may hold as collateral for such notes, bonds, or other obligations. The corporation shall, however, have power to make advances (a) up to one hundred per centum of the face value of any such loan or loans made by any such bank, banker, or trust company to any such person, firm, corporation, or association, or (b) up to one hundred per centum of the market value at the time of such advances (as estimated and determined by the board of directors of the corporation) of such bonds or other obligations by the purchase of which financial assistance shall have been rendered to such person, firm, corporation or association: *Provided*, That every such advance shall be secured in the manner described in the preceding part of this paragraph, and in addition thereto by collateral security, to be furnished by the bank, banker, or trust company, of such character as shall be prescribed by the board of directors, with the approval of the Secretary of the Treasury, of a market value, at the time of such advance (as estimated and determined by the board of directors of the corporation), equal to at least twenty-five per centum of the amount advanced by the corporation. The corporation shall retain power to require additional collateral security at any time.

(c) To make advances from time to time, upon such terms, not inconsistent herewith, as it may prescribe, for periods not exceeding ninety days, to any savings bank or other banking institution which receives savings deposits, on the promissory note or notes of the borrowing institution whenever the corporation shall deem such advances to be necessary or contributory to the prosecution of the war or important to the public interest: *Provided*, That such note or notes shall be secured by the pledge of securities of such character as shall be prescribed by the board of directors of the corporation with the approval of the Secretary of the Treasury, the market value of which, at the time of such advance (as estimated and determined by the board of directors of the corporation), shall be equal in amount to at least one hundred and twenty-five per centum of the amount of such advance: *Provided, further*, That the rate of interest charged on any such advance shall not be less than one per centum in excess of the rate of discount for ninety-day commercial paper prevailing at the time of such advance at the Federal reserve bank of the district in which the borrowing institution is located. The corporation shall retain power to require additional collateral security at any time.

(d) In exceptional cases, to make advances directly to any person, firm, corporation, or association whose operations shall be necessary or cuntributory to the prosecution of the war, for periods not exceeding five years from the respective dates of such advances, upon such terms, and upon the security of such bonds, notes, or other obligations, and subject to such rules and regulations as may be prescribed by the board of directors of the corporation, with the approval of the Secretary of the Treasury. The corporation shall retain power to require additional collateral security at any time.

(e) To subscribe for, acquire and own, buy, sell, and deal in bonds and obligations of the United States to such extent as the Secretary of the Treasury may from time to time determine.

(f) To issue and have outstanding at any one time its notes or obligations in an amount aggregating not more than eight times its paid-in capital, such notes or obligations to mature not less than one year nor more than five years from the respective dates of issue and to bear such rate or rates of interest and may be redeemable before maturity at the option of the corporation as may be determined by the board of directors, subject to the approval of the Secretary of the Treasury. Such notes or obligations shall have a first and paramount floating charge on all the assets of the corporation, and the corporation shall not at any time mortgage or pledge any of its assets. Such notes or obligations may be issued at par in payment of any advances authorized by this act, or for any of the

purposes of this act may be offered for sale publicly or to any individual, firm, association, or corporation at such price or prices as the board of directors may determine, subject to the approval of the Secretary of the Treasury. Such notes or obligations may be dealt in by Federal reserve banks in the same manner and to the same extent as bonds or notes of the United States not bearing the circulation privilege, and Federal reserve banks shall be authorized, subject to the regulations of the Federal Reserve Board, to rediscount and purchase paper and make advances secured by such notes or obligations in the same manner and to the same extent and at the same rates or at such higher rates as the Federal Reserve Board may approve, as they may purchase or rediscount paper or make advances secured by such bonds or notes of the United States under authority of the Federal reserve act. Any Federal reserve bank acquiring by purchase or rediscount such paper secured by the notes or obligations of the corporation may, with the approval of the Federal Reserve Board, use such paper so acquired for any purpose for which it is authorized to use paper secured by such bonds or notes of the United States: *Provided, however*, That whenever Federal reserve notes are issued against the security of such paper the Federal Reserve Board may make a special interest charge on such notes, which, in the discretion of the Federal Reserve Board, need not be applicable to other Federal reserve notes which may from time to time be issued and outstanding. All provisions of law not inconsistent herewith in respect to the purchase or rediscount by any Federal reserve bank of paper secured by such bonds or notes of the United States and in respect to Federal reserve notes issued against the security of such paper shall extend, in so far as applicable, to the purchase or rediscount of paper secured by the notes or obligations of the corporation and to the Federal reserve notes issued against the security of such paper.

(g) To exercise by its board of directors, and its duly authorized officers or agents, all powers specifically granted by the provisions of this act and such incidental powers as shall be necessary or proper to carry out the purposes of this act: *Provided*, That the powers specifically enumerated herein shall be deemed additional to, and not in limitation of, any implied powers granted by this act: *And provided further*, That it shall not exercise any of these powers or perform any business except such as is incidental and necessarily preliminary to its organization until it has been authorized by the President of the United States to commence business under the provisions of this act.

SEC. 7. That for the purpose of assisting in the prosecution of the war, and providing for the public security and defense, through the restriction of unnecessary capital expenditures, the corporation may, under rules and regulations to be prescribed by the corporation, with the approval of the Secretary of the Treasury, investigate and license, or refuse to license, the sale, or offering for sale or for subscription, of securities, as hereinafter provided. No person, firm, corporation, or association shall sell, or offer for sale or for subscription, any issue, or any part of any issue, of securities hereafter issued, the par or face value of which issue shall be in excess of $100,000, except in accordance with such rules and regulations as the corporation, with the approval of the Secretary of the Treasury, shall prescribe, nor, when required by such rules and regulations, except as permitted by licenses granted by the corporation. The corporation shall, however, grant licenses for any such sale, or any such offer for sale or for subscription, which it shall determine to be consistent with the foregoing purposes. Shares of stock of any corporation or association without nominal or par value shall for the purposes of this act be deemed to be of the par value of $100 each. Any securities which upon the date of the approval of this Act are in the possession or control of, or have been hypothecated by, the corporation, association, or obligor issuing the same, shall not be deemed to have been issued prior to the date of the approval of this act within the meaning hereof. Nothing in this act shall be construed to prohibit, or to require any license from the corporation in respect of, any borrowing by any person, firm, corporation, or association in the ordinary course of business as distinguished from borrowing for capital purposes. This section shall not be construed to apply to any securities issued by any railroad corporation the property of which may be in the possession and control of the President of the United States. This section shall not take effect until rules and regulations shall have been prescribed by the corporation, as hereinbefore provided, and may continue in effect until the expiration of six months after the termination of the war, the date of such termination to be determined by a proclamation of the President of the United States. Nothing done or omitted by the corporation hereunder shall be construed as carry-

ing the approval of the corporation or of the United States of the legality, validity, worth, or security of any securities.

Sec. 8. That whoever shall willfully violate any of the provisions of this act or of any license, order, rule, or regulation issued hereunder, or whoever shall willfully violate, neglect, or refuse to comply with any such license, order, rule, or regulation issued hereunder, shall, upon conviction in any court of the United States of competent jurisdiction, be fined not more than $5,000, or, if a natural person, imprisoned for not more than four years, or both; and any officer, director, or agent of any corporation or association, or member of any firm, who shall knowingly participate in any such violation, neglect, or refusal shall be punished by a like fine or imprisonment, or both.

SEC. 9. That all net earnings of the corporation not required for its operations shall be accumulated as a reserve fund until such time as the corporation liquidates under the terms of this act. Such reserve fund shall, upon direction of the Secretary of the Treasury, be invested in bonds, notes, or certificates of indebtedness of the United States, or, upon like direction, may be deposited in member banks of the Federal Reserve System, or may upon like direction be deposited in any of the Federal reserve banks. The Federal reserve banks are hereby authorized to act as depositaries for and as fiscal agents of the corporation in the general performance of the powers conferred by this act. Beginning six months after the termination of the war, the date of such termination to be fixed by a proclamation of the President of the United States, the directors of the corporation shall proceed to liquidate its assets and to wind up its affairs. Any balance remaining after the payment of all its debts shall be paid to and become the property of the United States, and thereupon the corporation shall be dissolved.

SEC. 10. That any and all notes and obligations issued by the corporation shall be exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, and (b) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations. The interest on an amount of such notes and obligations the principal of which does not exceed in the aggregate $5,000 owned by any individual, partnership, association, or corporation shall be exempt from the taxes provided for in subdivision (b) of this clause. The corporation, including its franchise and the capital and reserve or surplus thereof and the income derived therefrom, shall be exempt from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except that any real property of the corporation shall be subject to State, county, or municipal taxes to the same extent, according to its value, as other real property is taxed.

SEC. 11. That if any clause, sentence, paragraph, or part of this act shall, for any reason, be adjudged by any court of competent jurisdiction to be invalid, or in case any court of competent jurisdiction shall adjudge to be invalid any provisions hereof in respect of any class or classes of securities, such judgment shall not affect, impair, or invalidate the remainder of this act, but shall be confined in its operation to the clause, sentence, paragraph, part or subject matter of this act directly involved in the controversy in which judgment shall have been rendered.

SEC. 12. That the term "securities," as used in this act, includes stocks, bonds, notes, certificates of indebtedness, and other obligations.

SEC. 13. That the right to amend, alter, or repeal this act is hereby expressly reserved.

The Secretary is present, and we will be glad to have any statement from him with reference to this bill or any other matter. You may proceed, Mr. Secretary.

STATEMENT OF HON. WM. G. McADOO, SECRETARY OF THE TREASURY.

Secretary McADOO. Mr. Chairman and gentlemen of the committee, I have prepared a statement, which I wish, with your permission, to take the liberty of reading. I think it would be well for the

stenographer to take it down in spite of the fact that it is a prepared statement, because I may digress as I go along. I am sorry to say that this memorandum is longer than I had expected it to be, and I must therefore beg your patience and indulgence while I read it.

The proposed act to incorporate a War Finance Corporation should be regarded primarily as a measure to enable the banks, both national banks and State banks and trust companies, to continue to furnish essential credits for industries and enterprises which are necessary or contributory to the prosecution of the war.

The Government's borrowings, particularly during the period immediately preceding and following each Liberty Loan, have tended to preempt the credit facilities of the banks and often to prevent them from giving needed and customary help to quasi-public and private enterprises. Many instances have been brought to the attention of the Secretary of the Treasury and of the Federal Reserve Board where industrial plants, public utilities, power plants, railroads and others have found it difficult, if not impossible to obtain the necessary advances to enable them to perform vital service in connection with the war because essential credits, ordinarily available to them, are being absorbed by the Government itself.

In Europe central banks are permitted to grant to banks and bankers loans upon stocks and bonds upon certain well defined terms. The Federal Reserve Act does not provide for these and the War Finance Corporation is designed as a war emergency to fill this gap. The provisions of the Federal Reserve Act which permit Federal Reserve banks to rediscount and purchase commercial paper and paper secured by the Government's obligations have had the effect of forcing the banks to discriminate against loans on ineligible paper, even where such loans were vitally necessary for war purposes, in favor of loans on commercial paper even where they represented activities or enterprises not related to the war and which might well be curtailed during the period of the war. It is believed that the proposed bill has been wisely and conservatively conceived as a war measure to give relief from this condition during the war. The banks of the country would, no doubt, scrutinize with the utmost care both the loans themselves and the security therefor and would exercise their individual judgment upon the borrower's credit before assuming a liability for the amount of the loan, and also because they would be under the necessity of advancing, out of their own resources, 25 per cent of the amount loaned. The bill would authorize advances to a bank of only 75 per cent of the amount loaned by the bank on the notes or obligations of persons, firms, or corporations whose activities are necessary or contributory to the war.

The bill contemplates that the War Finance Corporation shall lend money to banks, both National and State, which are making loans to enterprises conducted by persons, firms or corporations producing materials or supplies, or doing anything else which is necessary for or contributory to the war. If a bank, for instance, should loan money, we will say, to a munitions company and take the company's six months' note with the company's bond as collateral security, that note would not be eligible for rediscount in the Federal reserve banks; but the War Finance Corporation in such circumstances could advance to the bank against the note of the munitions company, so secured with that bank's indorsement on it, 75 per cent of the face of that note.

Mr. TOWNSEND. Does it make any difference whether the banks are members of the Federal reserve system or not?

Secretary MCADOO. No, sir; it is intended to cover every bank, so that credit can be extended through the medium of this corporation in all cases where such credit would not be available now in similar circumstances.

Senator THOMAS. It is intended for the bill to go further than that, is it not?

Secretary MCADOO. Oh, yes; I am coming to that later.

Senator SMOOT. Is it intended that this corporation shall make loans direct to munitions manufacturers, or only to the banks doing business with that concern?

Secretary MCADOO. It can make them direct, as well, under certain restrictions which I shall come to later on.

Senator LODGE. You have not included savings banks there.

Secretary MCADOO. Yes, they are included; I shall come to them later.

Senator LODGE. That is very important.

Secretary MCADOO. That is provided for.

The provision of the bill permitting direct loans by the corporation in exceptional cases is intended to provide for those rare instances where it may be made to appear to the corporation that a meritorious borrower is being unwisely discriminated against by the banks.

As a corollary to the provision for the extension of credits the bill provides for approval by the corporation, through a system of licenses, of issues of securities with a view to preventing the use of capital in unnecessary expenditures during the period of the war.

It is important that appropriate provision be made by law, so that, for the duration of the war, funds available for investment in securities shall be effectively and economically used to supply the financial requirements of the Government and of those industries whose operations are necessary or contributory to the war. The ordinary flow of capital, which in normal times is left free to seek its own investment, should during the war be so directed and conserved that these requirements shall be taken care of before funds shall be invested either in new enterprises or for the expansion of such old enterprises as are not necessary or contributory to the prosecution of the war. In these critical times funds available for investment must not be dissipated on miscellaneous capital expenditures which, however useful or desirable in normal times, will not now aid in the success of the war. It is not so much a question of money as a question of labor and materials. It is essential that the demand for labor and materials for industries which are not contributory to the prosecution of the war should be kept within bounds, so that the war needs shall be first provided for. The test must be whether the proposed expenditure will strengthen the industrial and military structure of the country for the purposes of the war.

The Secretary of the Treasury has already asked the voluntary submission to the Federal Reserve Board of any projected capital issues and has asked the Federal Reserve Board to pass upon such issues. The Federal Reserve Board is already performing this patriotic service. The work which the board has undertaken along these lines should be regarded as preliminary and as laying the basis and furnishing in no small part the organization for the work which the corporation will have to do. While patriotic business men and bankers have in many instances voluntarily submitted the question whether the particular security issue then contemplated will be in any way helpful to the prosecution of the war, it is certainly not desirable that matters of such great importance should be left upon a purely voluntary basis. These questions should be dealt with systematically under authority of Congress. The thoughtful and pa-

triotic citizen who voluntarily submits his plans to the Government should not be placed at a disadvantage with his less thoughtful or less scrupulous fellow-citizen who goes ahead with his private affairs without reference to the war needs of his country.

Senator TOWNSEND. This is an argument in favor of the license?

Secretary MCADOO. It is intended to be, and I hope it may prove convincing.

The proposed license system for security issues is in line with the act which established the selective draft in lieu of a voluntary system of creating an army. The sacrifices which must be made if the war is to be won should be made by all alike and not merely by those whose patriotism impels them to volunteer and who would have to carry the entire burden unless the slackers are compelled to do their part.

The bill has been drawn with the double purpose of restricting unnecessary capital expenditures and of providing facilities for aiding those industries whose operations are necessary or contributory to the prosecution of the war. Broadly speaking all these are "war industries." The bill is purely a war measure; designed to conserve the supply of labor and materials for the purposes of the war, and to help supply the war's financial requirements, and to give them a first claim on capital seeking investment in like manner as the war's material requirements have been given a first claim on productions. By the term "war industries" is meant not only those industries turning out the actual munitions of war but also all those supplying any of the other elements of production or distribution in an industrial structure designed to meet the diversified requirements of the war. The bill is not intended to interfere with the continued existence and operation of existing industries, even though not remotely contributory to the prosecution of the war. Such industries should not, however, be permitted to assert a first claim on fresh capital or be considered until the requirements of the Government and of the "war industries" have been fully met.

The proposed bill creates the War Finance Corporation, to regulate the sale of new issues of securities, and to make loans of its funds or its credit in aid of "war industries." It prohibits any person, firm, corporation, or association from selling or offering for sale any securities issued after the date of the approval of the act unless a license for such sale or offering (if required by the corporation) shall have been obtained from the corporation. Through its regulation of security issues the corporation will be able to keep the field somewhat clear for the borrowing operations of the Government, and at the same time will stand ready and able to aid "war industries" whose financial requirements may be rendered difficult if not impossible to meet in competition with Government loans. This regulation of security issues will also tend to prevent the further diversion of labor and materials into nonessential industries.

The entry of the United States into the European war immediately necessitated a vast increase in the country's production of material, which in turn necessitated an increase in the machinery of production and corresponding enlargement of land and water transportation facilities. No such enlarged demand could be met without increased demands upon the banks for commercial credits to pro-

duce the goods required and upon capital both for enlarging the machinery employed by our industries and for developing railroad facilities, for building ships, and for other purposes. Fortunately the establishment of the Federal Reserve System had already provided the means through which the financing of the greater commercial turnover could be largely taken care of and this has been supplemented by the Government's policy of making advances through the War Credits Board of the War Department to manufacturers upon work in process for the Government. I do not regard advances of this character with favor as it tends to force upon the overburdened Treasury the load of financing private enterprises through the indirect medium of the War Department, when such transactions ought to be made through the banks. If the banks are unable to meet such demands, then the War Finance Corporation can do so and relieve the strain now unwisely imposed directly upon the Treasury.

Permit me to say in connection with that statement about the advances now being made through the War Department that I am not criticising the act which authorizes that to be done. The War Department, as you know, and I think also the Navy Department, has the right to make advances on Government contracts of not exceeding 30 per cent, at the discretion of the heads of those departments.

Senator TOWNSEND. You say you do not propose in this bill to interfere with going concerns now. Do you propose to regulate their issues for refunding any of their present obligations?

Secretary MCADOO. No, I do not think that would be interfered with, Senator. Wise administration of the corporation would undoubtedly require in ordinary cases that securities issued for refunding purposes should be licensed. There might, of course, be extreme cases where the War Finance Corporation might want to force the use of available accumulated earnings of an industry to pay maturing obligations instead of having such earnings invested in additional plant facilities or otherwise disposed of. Possibly in an extreme case of this sort where the company had the funds to pay maturities a license would not be granted to issue securities for refunding purposes.

It seems to me wise that the corporation should have the power to regulate securities issued even for refunding purposes, for if issues of this character should be excepted from the regulation of the corporation it would open the door for a lot of "camouflaged" refunding operations which on investigation might turn out to be of quite a different character. I believe that this has been the experience of the Capital Issues Committee of the Federal Reserve Board about which I shall have something more to say later on.

I want to say a few words more on the question of advances upon Government contracts. We find that contracts are made, and that the departments have the power to make these advances to the contractor, without consulting the Treasury at all. They do not have to consult the Treasury under the law. They do not decline to consult the Treasury but everybody is very busy, and they proceed under authority of law and make these contracts from their own particular standpoints upon the assumption that the Treasury is

ready to meet any strain that may be put upon it. We are now trying to work out a plan for consultation with the other departments, and there is a thorough disposition on their part to consult with the Treasury and to cooperate with respect to such advances, so that they will not be made without our knowledge and so that unusual demands will not come upon the Treasury without notice. But I think the practice is bad, because these contractors are only too willing to get advances from the Government at a lower rate of interest than they are really entitled to from the commercial standpoint. In this indirect way these contractors divert to the Treasury financial transactions that ought to be conducted through the banks, and would ordinarily be conducted through the banks.

Now, if the banks are unable to finance those demands, this Finance Corporation could step in the breach and finance the demands upon a character of security that a commercial bank might not like to take. Even though the banks may not now be in position to do this financing, after the War Finance Corporation has been established they could very properly do it because the War Finance Corporation could always come to their relief and take paper which would be unavailable for rediscount in Federal reserve banks.

Senator TOWNSEND. Does not the Treasury encourage prospective contractors to obtain money from the Treasury or the Federal reserve banks, in order to start their business?

Secretary MCADOO. How do you mean, Senator?

Senator TOWNSEND. I have understood from a prospective contractor, discussing the question of a contract with the Government, that one of the inducements held out to him is that he can obtain from the Government a certain per cent of the capital necessary to start in business.

Secretary MCADOO. Those matters would not be submitted to the Treasury. They would proceed through the department making the contract. Perhaps they held out that inducement. But I think it is very much better to finance those undertakings through the medium of a corporation of this character, or through the banks, rather than to throw upon the Treasury indirectly the burden of engaging in banking transactions and carrying the entire load of the enterprises of the war. The Treasury can not do it; we must have some medium through which that must be more properly and equitably distributed.

Senator MCCUMBER. Unless the interest rates were less than the Government rates, how are you going to escape that?

Secretary MCADOO. Unless they are permitted to get 30 per cent of their contracts at the rate of interest the Government is paying for money they will have to pay the going rate through the banks. This corporation, if it is organized, can meet the situation and help stabilize the rate and also assure the banks the credit.

Senator MCCUMBER. Will the Government then discontinue this practice of furnishing money to contractors?

Secretary MCADOO. I think it ought to be done; I think it ought to be handled through this other means.

Senator SMOOT. I can not see that there is any burden placed upon the Treasury, because the appropriations are already made. If you throw on the banks the burden of advancing this money, the banks

being already burdened as heavily as they can possibly bear, it would require them to do more than they could possibly do; and it seems to me that as long as the appropriations are made and we know that the Treasury has got to meet them, the easiest way for any concern working for the Government would be to get their money from the Government, even if the rates were just the same as in the case of the banks.

Secretary McADOO. The difference is this: The Treasury has a tremendous load anyway to carry, and that load ought to be distributed and spread over as long a period as possible. The Treasury can not lug everything, and the result is that if you make an advance before anything is done by the contractor, of say, 30 per cent on a one hundred million-dollar contract, that is $30,000,000, you immediately call on the Treasury for that amount and the Treasury has to borrow it and lend it to the contractor. Of course, that adds to the burden of the Treasury, when the financing ought to be distributed over a longer period and through a large number of agencies. If contractors can not get credit through the banks, then the War Finance Corporation can step in and handle the situation for them.

Senator SMITH. You do not endeavor to keep all the money in the Treasury for all the appropriations made, but endeavor to get it when the appropriations would legitimately mature, and this should go through a banking institution instead of having these irregular and unanticipated calls on the Treasury?

Secretary McADOO. Precisely; that is the purpose. It spreads the demand on the Treasury over a longer period. It does not require the Treasury to engage in banking transactions. I shall now continue with my statement.

The money required for increased facilities for ocean transportation has been provided by Act of Congress. Provision for at least a part of the money required for enlarging railroad transportation facilities is contemplated in legislation now pending in Congress.

The necessary increase, however, in machinery to produce goods, which requires the investment of capital in industrial enterprises not only has not been provided, but a considerable restriction has been imposed upon the usual supply of capital for investment, partly by reason of the investment market having been preempted by the Government through the issue of its own bonds and partly because of the natural tendency of investors who, notwithstanding that they have money to invest, hesitate to do so on account of the uncertainties of war.

The situation with which the country is confronted, therefore, seems to require the imposition of reasonable restrictions upon the investment of capital in industries and production not essential for the conduct of the war. It is equally important that there shall be some means of supplying necessary capital to the industries which are essential to the production of war materials and of those things which indirectly contribute to the efficiency of the Nation. The restriction of unnecessary capital expenditures will relieve the market of demands which now interfere not only with the direct financial requirements of the Government, but which make it difficult for those who are furnishing the Government and the people with essential goods to obtain the capital necessary to increase their production.

The license system proposed is peculiarly applicable to a country of the great size of the United States, where banking and credit transactions are conducted by a vast number of independent banks and private banking firms.

The combined operation of the two functions of the corporation—that is the extension of credit and licensing—will make the exercise of supervision and regulation by the corporation much more effective in putting the productive activities of the country on a war basis than would be the case were

the Government simply to make advances without at the same time exercising supervision and control of security issues.

In so far as the corporation may be called upon to make advances to banks, its first concern would naturally be to aid those for which other instrumentalities of relief have not already been provided; for example, savings banks, and particularly mutual savings banks, which are without capital stock, and which are not operated for the profit of stockholders. As a class these institutions are not members of the Federal Reserve System nor are most of them eligible for membership. Their investments consist for the most part of the securities of the United States and of States and municipalities and of the bonds of industrial, transportation, and utility companies, and also mortgages.

Nothing will tend so greatly to prevent the development of any possible uneasiness among savings bank depositors as the assurance provided by this act that any solvent savings bank in case of sudden withdrawals can obtain advances upon the security of its investments and promptly liquidate the claims of its depositors. There is considerable apprehension among savings banks as to means of relief if an emergency arises but I believe that the assurances of support which this War Finance Corporation will provide, will allay all apprehension and probably head off any demand for withdrawals of deposits.

Senator GALLINGER. Will you indicate the exact provisions in the bill concerning savings banks?

Secretary MCADOO. Yes, sir; I am coming to that, Senator.

Senator GALLINGER. Because there is very great apprehension, and I would like to know specifically what is proposed.

Secretary MCADOO. I think the provisions of this bill will amply meet that situation.

The next concern of the corporation would be the requirements of commercial banks, which are unable to get required accommodation upon the security of their investments through the Federal Reserve Banks. Many banks which are now called upon to extend large lines of credit to customers which are expanding their businesses to meet the present needs of the Government are obliged to take securities from these customers which are not eligible for rediscount at Federal Reserve Banks. At the same time these banks are being called upon to extend larger lines of credit to their customers than ever before. Their customers are calling upon them not only for commercial loans to carry their large inventories, but for what are in effect temporary capital loans in order to construct new facilities and add machinery to existing plants for the purpose of filling Government contracts. The burden of these banks is also heavily increased by the financial requirements of the Government which at the same time is calling upon them to lend large sums through sales of Treasury certificates of indebtedness.

In these circumstances the commercial banks are quite naturally discriminiating in their loans between those eligible for rediscount by Federal Reserve banks and those which are not. The proposed act, however, would remove the ground for any such discrimination for it provides a means by which such banks may procure accommodation upon certain securities arising out of war conditions which are not eligible at Federal Reserve banks. The proposed act would thus free credit pressingly needed at the present time both directly and indirectly for the Government's use.

I shall give one or two illustrations of pressing needs which it is hoped that the War Finance Corporation may be able to meet. It is not necessary to multiply examples as every one at all familiar with existing industrial and financial conditions will be able to supply other illustrations from his own knowledge.

There has been called to my attention the case of an important and successful power company, whose business is showing substantial increases, and whose power is consumed largely in war industries. It has recently made a public offering of its securities. The proceeds of the securities were to be used in part to pay maturing obligations, and in part for needed extensions to plant. The capital issues committee of the Federal Reserve Board had determined this issue to be compatible with the national interest. After a public offering in the usual way, less than 20 per cent of the entire amount was sold, and most of these sales were made to persons whose prior investments in the company's securities made it desirable that the issue should be a success. This is only one

illustration of the difficulties with which even the most successful industries having maturing obligations or pressing capital requirements are confronted.

Another instance will show the importance of dealing with this matter promptly. A power company operating in central Pennsylvania is under insistent demands for power for the operation of coal mines; approximately 80 per cent of its power being utilized for that purpose. Under ordinary conditions, it was stated by one of its officers, the company would sell at the present time about $1,500,000 of securities for the purpose of completing necessary extensions and construction work. Being unable to do so, the company is borrowing about $500,000 on short loans from small local banks throughout its territory. A demand on the part of a few of these banks for repayment of loans could not possibly be met and not only would extension work cease, but the company might face a receivership. Relief in this sort of case in view of the urgent necessity for an enlarged production of coal is of vital importance.

A similar situation in Michigan has been called to my attention. A public utility corporation has $5,000,000 of notes maturing, all having been issued for construction purposes. This company is now borrowing over $5,000,000 in short loans from different banks. There is an insistent demand from the industries of that section for more power for manufacturing purposes, which the company is unable to meet because of lack of adequate capital and because of the uncertainty of its position with such a large floating debt.

The necessary restriction of passenger transportation by the steam railroads during the present period of congestion will throw greater burdens upon urban and interurban railroad lines which will therefore require for their operation a greater amount of electric power and doubtless some extension of their facilities. In some cases, no doubt, enlargement of their facilities is directly required for the Government's service at the various Army encampments. Borrowings for such purposes are not eligible for rediscount with Federal reserve banks, and necessary provision must be made for the development of such lines.

A very large part of the manufactures of the country are conducted by the use of electric energy, for which the demand in some parts of the country necessitates immediate enlargement of production by both steam and hydroelectric power. Indeed, I am informed that in some important industrial districts there exists a distinct shortage of electric power, which is badly needed for war industries. If this deficiency is to be supplied, additional facilities must be procured, and money is urgently needed for the necessary capital expenditures. Existing financial conditions are such that power companies find themselves unable to procure these funds on reasonable terms. That these funds should be obtained to produce the power needed for our war industries is a matter of prime importance, and yet, at the present time, it is difficult, if not impossible, to obtain these funds through the ordinary channels.

Since the publication of the terms of the proposed act, some criticism has appeared indicating a belief that the operation of the corporation may produce expansion, or, as some term it, inflation, of a dangerous nature.

In my opinion the existence of this corportion and the intelligent exercise of its functions will do more to prevent unsafe expansion than any other course which could now be pursued, for it must be remembered that the investment markets are practically closed to the country's industries, including public utility corporations and the railroads. These essential industries and transportation companies in these circumstances, in the absence of some such plan as is presented in this bill, are obliged to look to the banks for the means, not only of continuing their normal business, but of enlarging it for war purposes. The needs of these corporations, which sound finance would require to be provided for in the form of capital loans, must now increasingly be taken care of in the form of bank loans. The burden placed upon the banks to meet the demands of this class of borrowers can only be met if these banks use the facilities of the Federal reserve banks by discounting such eligible paper as they may have in their portfolios. The continuance of this process of looking more and more to the banks for short loans of funds which should be provided as capital by investors is the quickest way to bring about an unsound expansion of bank credits. If this burden, through the instrumentality of the War Finance Corporation, can be removed from the banks, and if investors can be induced to furnish necessary capital, that kind of expansion will be checked.

The intervention of a corporation of this character, with its large capital, will provide the class of security which will appeal to the minds of even the most timid investors and will naturally assist in converting what might become a dangerous bank expansion into a legitimate investment of free capital. Even

though the corporation were not called upon to make any considerable advances itself, so that the issue of its own securities to a large extent might not be required, it has been the experience in Great Britain, and I believe it will be our experience also, that the restraint imposed upon unnecessary capital borrowings, through Government intervention such as is proposed, not only allays the fears of timid investors, but stimulates a demand generally for issues of licensed securities. Such securities sell promptly and their distribution is general and effective. This again provides a check to unwise expansion of bank credits.

Senator PENROSE. Have they in England a scheme similar to the one you are proposing?

Secretary MCADOO. Yes, sir; not a War Finance Corporation, but through other agencies. They have a capital expenditures committee which exercises a governmental function.

Senator PENROSE. It is practically equivalent to this?

Secretary MCADOO. Yes, it is practically equivalent to this.

Senator GALLINGER. What about the other great nations, France and Germany?

Secretary MCADOO. I understand they both have similar arrangements——

Senator THOMAS. They also have issues of uncovered paper.

Senator SMOOT. Yes. This is the same thing.

Secretary MCADOO. No, it is not the same thing. I should like Senator Smoot to withhold judgment at this time, because that is exactly what this bill does not provide.

Senator PENROSE. Have those operations been entirely satisfactory in England?

Secretary MCADOO. Yes sir; in fact, that was absolutely vital to the conduct of the war.

Senator PENROSE. Is their method of operation about the same?

Secretary MCADOO. They do not handle it in the same way; they have a committee authorized by the Government, acting under the British Treasury, to pass upon capital expenditures; but they use the Bank of England, practically, for the functions of this corporation, because it is practically a government war finance corporation.

Senator SMOOT. The limit of issue is removed in the Bank of England to-day?

Secretary MCADOO. I am not so sure about that. Mr. Warburg can tell you about that.

Mr. WARBURG. It has a large fund of securities.

Senator SMOOT. I am not speaking about the question of securities. I simply say the limit of issue of the Bank of England has been removed, and is removed up to the present time.

Mr. WARBURG. They have not done it directly, but largely by indirection.

Senator THOMAS. In other words, the bank act has been suspended.

Senator SMITH. The limit still exists upon the Bank of England, but this additional emergency paper money is put in circulation.

Senator SMOOT. Mr. Secretary, so that you may not misunderstand what I said, I am quite certain that we have got to arrange some kind of plan for taking care of the expanded business of our country, and I will go farther than that and say that in order to do that there has to be a greater issue of moneys on the part of the Government, back of which there can not be the gold reserve that we have had in the past.

Secretary McADOO. We may be obliged to come to that, I am not prepared to say that we shall not; but we have not come to that yet. If we are obliged to come to it let us do it in the most conservative and sound fashion.

Senator SMITH. At least for the present this financial scheme will avoid that situation?

Secretary McADOO. I think it will.

Senator SMITH. And it will be vastly better if it can permanently avoid that.

Senator SMOOT. This will authorize the issue of at least four billions of money.

Secretary McADOO. Oh, no. That is a common misunderstanding of this bill.

Senator SMOOT. I have not had a chance to read the bill through.

Secretary McADOO. Perhaps I can clarify that, Senator, as I go along with the statement.

The CHAIRMAN. I understand you are going to take the bill up section by section, and I think then Senators could ask questions, and it would save time and would be less embarrassing to the Secretary.

Secretary McADOO. It is no embarrassment to me, gentlemen. I believe, however, that you would find it more satisfactory if I finish my statement and then you question me about it.

The functions of the corporation are intimately connected with Government finance, and are, therefore, within the peculiar province of the Treasury Department. The War Finance Corporation is an administrative device for exercising governmental regulation of security issues during the war and for utilizing for war purposes the revolving credit created from the proceeds of its capital stock and other securities. As the operations of the corporation must be harmonized with the financial operations and policy of the Government itself, the proposed bill provides that the Secretary of the Treasury shall be a director and chairman of the board of directors and imposes upon him certain other duties in connection with the corporation. A somewhat fuller statement of the functions and operations of the corporation is given below under the appropriate section numbers of the act.

SECTION 1.

For the purposes outlined above, the Secretary of the Treasury and four additional persons, to be appointed by the Secretary of the Treasury, with the approval of the President, are created a corporation, under the name of the "war finance corporation."

The CHAIRMAN. Now have you reached the part of your statement where you are going to deal with the sections of the bill?

Secretary McADOO. Yes, sir.

The CHAIRMAN. Do you desire to read all of that and make an oral statement afterwards?

Secretary McADOO. I will read this and ask you to interrogate me afterwards, if you will, Senator. This is explanatory merely.

The Secretary of the Treasury and these same four persons will constitute the original board of directors. The life of the corporation by the terms of the bill, is limited to 10 years, but its powers are to cease, except such as may be necessary to its successful liquidation, six months after the termination of the war.

SECTION 2.

The capital stock of the corporation is fixed at $500,000,000, all of which is to be subscribed by the United States, and for that purpose an appropriation of a like amount is made. Payments upon this subscription will be called only when

three-fifths of the board of directors shall so determine. The capital stock was fixed at this amount to provide the corporation with substantial resources with which to aid "war industries" and to furnish an additional equity for any other securities issued by the corporation.

SECTION 3.

The management of the corporation is vested in a board of directors, constituted as stated above. The directors are to serve for four years; and provision is made in the following section for rotation in office, so that two directors shall retire every two years. The power of removal is vested in the Secretary of the Treasury, with the approval of the President.

In connection with that provision I wish to say this: I understand there has been some criticism of the powers conferred upon the Secretary of the Treasury in this bill. The policies of this corporation and its operation must be integrated and articulated absolutely with the Treasury if it is to perform the functions which it ought to perform, just as much so as the functions of the Treasury must be articulated through the Secretary and the Assistant Secretaries. As a matter of fact, all we are now proposing to have done could be done through the ordinary Treasury machinery if we could use the Treasury of the United States to issue obligations or bonds of the character proposed by this bill; but of course the Government of the United States can not conveniently engage directly through the Treasury in this form of security issues. The bill creates a corporation of a character which may take collateral securities for loans and obligations indorsed by the banks, which the Treasury should not do. Therefore the Secretary of the Treasury should be put as nearly as it is possible to put him in the same relative position with regard to the management of this corporation that he holds with respect to the management of the Treasury through the Assistant Secretaries; naturally, however, he would not have such power over these directors as he would have over the Assistant Secretaries of the Treasury, but we ought to approach that situation as nearly as possible in order to insure an absolutely harmonious cooperation of this corporation, and coordination of its operations and policies, with those of the Treasury Department. That is the reason the bill is framed in this way.

Senator PENROSE. Would it not be better to follow the orderly procedure and have the President appoint the directors instead of the Secretary of the Treasury?

Secretary MCADOO. I have not the slightest objection to that. The President is already overburdened.

Senator PENROSE. You will begin to be overburdened with the railroads and the Treasury, and the number of things that are concentrating on you.

Secretary MCADOO. I hope I shall not.

Senator PENROSE. I think it would be more according to the usages of Congress. I am only making the query whether it would be better to have these directors appointed by the President and perchance confirmed by the Senate.

Secretary MCADOO. I have no objection to that, Senator.

Senator PENROSE. The President appoints the Assistant Secretaries, and the Commissioner of Internal Revenue.

Secretary MCADOO. As I said, I have no objection to that.

Senator PENROSE. In the administrative feature of the bill I think we could well follow the precedents of a hundred years, which have worked very well.

Secretary MCADOO. I make not the slightest point on that. If the Congress should think it would be better to have these directors selected by the President and confirmed by the Senate it would be perfectly agreeable to me.

Senator PENROSE. I have never heard of the Secretary of the Treasury appointing an important official with the approval of the President.

Secretary MCADOO. Well, I appoint a great many men with the approval of the President.

Senator PENROSE. To positions not created by Congress; merely by the President, maybe.

Secretary MCADOO. There are many appointments in the Treasury Department of very great importance that are not confirmed by the Senate. However, I make no point on that. It is perfectly agreeable to me to have it changed if you think it advisable.

SECTION 4.

The corporation is authorized to establish branch offices, though the principal office is required to be located in the District of Columbia.

That is done so that the corporation may be reached at different points throughout the country, without requiring everything to be sent to Washington. My idea is that the Federal reserve banks, which are the fiscal agencies of the Government, are a very useful nucleus for that organization, the Federal reserve banks with their branches.

SECTION 5.

Following the analogy of the Federal Reserve Board, no officer or director of the corporation is permitted to continue to be a member of the board of directors of any other corporation or a member of any banking firm.

I am frank to say with respect to this provision that I am not sure that we ought to make such a severe restriction. I put it in because some people are sensitive about these matters, but as this is an emergency measure perhaps we ought not to require men of ability to give up every interest they have to come and serve temporarily in an organization of this kind.

The CHAIRMAN. That would very greatly restrict the field of selection.

Senator THOMAS. They could resign.

Senator LODGE. Some of the very men you might want to get may not be able to do that.

Secretary MCADOO. It involves a very great sacrifice for a man to give up everything and take a temporary position. It restricts the field; that is all.

The bill specifically provides, however, that this requirement shall not prevent the appointment of any member of the Federal Reserve Board or of any other governmental administrative body or of a director of a Federal reserve bank. The directors are required to devote their entire time to the business of the corporation except such time as they may give to other governmental business. They are to receive salaries to be fixed by the Secretary of the Treasury, with

the approval of the President, not in excess of the salary of the head of an executive department of the Government.

Senator SMITH. Would it not be sufficient to say not in excess of the salary of a member of the Federal Reserve Board?

Secretary MCADOO. That is the same, $12,000. That limits it. The reason I have put the provision in that form, gentlemen, is this: It may be possible that many men who would be willing to serve would prefer to serve without salary, and in such cases we would be permitted to take the benefit of such service if they preferred to give their service for nothing. That merely gives the Secretary of the Treasury, if they want to serve for less, opportunity to make the arrangement; but in any event they would not be paid more than $12,000. The bill goes on to provide that if any director is receiving from the United States any other salary or compensation for services, the amount of the salary to be received from the corporation, together with any other amount so received from the United States, shall not exceed the salary to be fixed, as stated.

SECTION 6.

This section defines the corporate powers of the corporation, including the specific provisions for extending aid to "war industries," while the regulation which the corporation is to exercise over security issues is provided for in section 7.

The corporation is granted (subdivision (a)) the ordinary powers and privileges enjoyed by corporations, including, among others, the power to sue and be sued, to contract, to adopt a corporate seal, to appoint officers and agents, and, with the approval of the Secretary of the Treasury, to adopt by-laws for the conduct of its business and to define the powers and duties of its officers.

The corporation is empowered (subdivision (b)) to make advances, for periods not exceeding five years, upon such terms as it may prescribe, "(1) to any bank, banker, or trust company"—you see, it is not limited to banks in the Federal Reserve System—"and which has outstanding any loan or loans to any person, firm, corporation, or association whose operations shall be necessary or contributory to the prosecution of the war and evidenced by a note or notes, or (2) to any bank, banker, or trust company which has rendered financial assistance, directly or indirectly, to any such person, firm, corporation, or association by the purchase of its bonds or other obligations." The bill thus provides two different methods for extending aid indirectly to "war industries" through any bank, banker, or trust company (referred to generally as a bank). These two different methods have no sharply defined line of demarcation, but they are based upon two generally distinct devices used in corporate finance. The first method is where financial requirements are provided for through bank loans, and the second method is where such requirements are provided for through the sale of securities.

The first method (see (1) in preceding paragraph) applies when the bank has made a direct loan to a "war industry" evidenced by a note. This is the ordinary bank transaction, and the bill provides that the corporation may make an "advance" to the bank to the extent of 75 per cent of the bank's loan to the particular war industry.

The second method (see (2) above) of extending aid to a "war industry" through a bank, applies where a bank has purchased the bonds or other obligations of a "war industry" either directly from a "war industry" or from others. The "war industry" has been benefited by the sale of its securities, whether this sale has been made directly by the "war industry" to the bank or indirectly through others, and the corporation is therefore authorized in either case to make an advance to the bank. These "advances" may be made to the bank up to 75 per cent of the "market value" of the bonds or other obligations of the "war industry" acquired by the bank. It provides a method by which banks may procure funds from the corporation upon this class of securities.

Let me take the case of a power company, for instance, which is furnishing a large amount of power to coal mines. Suppose a bank had bought $100,000 of the bonds of that power company. The power company would be, of course, a war industry, because it is furnishing power for the production of coal, which is used, in turn, to run the factories that are turning out war munitions or other supplies needed for the war. In such case the War Finance Corporation may loan to that bank 75 per cent of the market value of the bonds which the bank has bought.

Under either of these provisions (1) or (2) the aid extended by the corporation to the "war industry" is indirect and the advances made to the bank are always secured by the obligation of the bank. This plan enables the corporation to aid "war industries" through the ordinary banking channels. In either case the bank must not only give its own note to the corporation for the amount of the advance received from the corporation, but must also secure that note by the notes or bonds or other obligations of the particular "war industry" the purchase or acquisition of which forms the basis for the advance by the corporation.

Senator McCUMBER. How about the question of interest?

Secretary McADOO. The interest rate, of course, will be determined by the War Finance Corporation itself. That is a matter of contract between it and the bank to which it may make an advance.

Senator McCUMBER. This question might arise: That bank loans a million dollars to one of these producing corporations at 6 or 7 per cent. Then the Government will furnish the bank three-fourths of that money. Would the Government furnish it at 3 per cent and let the bank receive 6 per cent?

Secretary McADOO. That will be done exactly as we do now through the Federal Reserve Board when a credit is extended to a member bank. The rediscount rates of the Federal reserve banks are determined by the Federal Reserve Board. The War Finance Corporation's rate would be determined by its directors, and would, I think, have to be as much or more than the rediscount rate of the Federal reserve bank to make it safe on the transaction.

The CHAIRMAN. In other words, if the Federal reserve charge is 4 per cent——

Secretary McADOO. Then it would be not less than 5 per cent.

Senator SMITH. The outside bank would charge probably 1 per cent more than it had to pay, just as you charge 1 per cent more than you had to pay the Federal reserve bank?

Secretary McADOO. The transactions are not related in that way. Suppose the First National Bank of Atlanta had loaned to a corporation producing war materials $100,000 and had taken bonds as collateral security, and suppose it had charged the corporation 6 per cent. Then two or three months afterwards suppose it wanted to rediscount that paper with the Federal reserve bank. The bank would charge a rate of interest which had relation to the market condition at the time, depending upon what money was worth at the time.

Senator SMITH. What I meant was that in the ordinary course of business a bank's rate would be a little higher than the rate you charge the bank, and yours a little higher than you would have to pay the reserve bank.

Secretary McADOO. Very likely.

Senator SMITH. That would be the natural course of business, though not prescribed?

Secretary McADOO. Yes.

The CHAIRMAN. That is the case with the Federal reserve banks.

Secretary McADOO. The terms of the advances, including the interest rate, are to be determined by the corporation, with the limitation that no advance is to be for longer than five years.

As alternative arrangements, instead of 75 per cent advances to the banks, advances may be made by the corporation up to 100 per cent of the particular loans made by the banks to a "war industry," or up to 100 per cent of the market value of the bonds or other obligations of a "war industry," provided that in either case the bank, to which the particular advance is made, shall itself supply additional collateral to the extent of 25 per cent of the advance.

These provisions as to security require in effect that the corporation shall have an equity of at least 25 per cent in the security for the advances in addition to the obligation of the bank, to which the particular advance is made.

You can see the whole theory of this bill will oblige the corporation to take only well secured loans, just as Federal Reserve Banks are required to take only well secured loans.

The corporation may (subdivision (c)) make advances directly to savings banks and other banking institutions which receive "savings deposits" on the note of the borrowing institution, secured by collateral to the extent of 125 per cent of the amount advanced. The duration of these advances is limited to 90 days.

Senator LODGE. They are limited to 90 days?

Secretary McADOO. To 90 days.

Senator LODGE. That is viewed with a great deal of apprehension. I do not know that I have the figures correctly, but there as about fourteen billions in the savings banks. In my own State there is about a $1,000,000,000 in savings banks, and it is very important not to bring about a situation which would impair such enormous funds as that, which we need, of course. Savings-bank securities are not easily liquidated; many of them are slow of movement. I think we ought to be very careful about savings banks.

Secretary McADOO. The duration of these loans could be made longer; if necessary we could make it a year. My feeling about this bill has been that in such cases the money should be made avail-

able upon the same restriction as to maturity that is now provided for commercial paper eligible at Federal Reserve Banks. I think that when the savings banks know they have this certain protection you are not going to have any trouble with the savings banks, anyway. The minute means of protection are provided you will find that the apprehension will disappear.

Senator LODGE. The telegrams that I get are to the effect that they do not regard this as sufficient protection.

Secretary MCADOO. Because of the 90 days?

Senator LODGE. I think that is one reason.

Senator SMOOT. Savings-bank loans are always for a longer period than that.

Secretary MCADOO. But they can always get renewals.

Senator GALLINGER. But I understand you do not object to making it six months?

Secretary MCADOO. Six months or a year.

Senator GALLINGER. I will take the libery to read a telegram received yesterday from the chairman of the board of bank commissioners of New Hampshire, with the promise that a letter would follow, which has not been received. In that connection I will say that the bank commissioners of the New England States had a meeting recently either in New York or Philadelphia and discussed this matter, and they were very much disturbed over the time limit in the bill. This telegram says:

If the Finance Corporation bill limit loans to savings banks to 90 days and makes rate 1 per cent in excess of discount rate at Federal reserve banks it will afford us no relief. This feature of bill very important to savings banks of New England and Middle States having most of the six billion savings deposits of the country. See letter to-day for you to present to Finance Committee.

The two points that they were disturbed over were the time limit and the rate, which they have felt might be limited to the established rate of savings banks, which is about 4 per cent.

Secretary MCADOO. You see, Senator, these are emergency measures, and if, because of the emergency, a higher rate has to be paid there is no reason why a savings bank ought to be more favorably treated than other institutions that may be equally important. Again, you must remember this, that if you make the rate the same, or so low that you encourage people to resort to this corporation for loans, it will not have capital enough to do the business. They ought not to resort to this corporation for loans unless there is really a necessity for it, and they will not do it in those cases if the rate is to some extent a penalty. It is similar to the provisions formerly existing about issues of emergency currency. It was very important for the banks to have emergency currency, but the taxation was made very high in order to deter them from needlessly expanding credits and precipitating the very conditions we want to prevent. What we want is to afford relief when necessary, but not to encourage people to expand because they can get money through this medium at a low rate of interest. I am quite sure that the savings banks would be very fairly treated if the bill should extend the time to six months or a year, leaving the rate of interest to be determined by the corporation.

Senator GALLINGER. I assume, Mr. Secretary, that it is fair to conclude that the Treasury Department understands fully the danger confronting the savings banks. As an illustration, the last Liberty loan was floated at 4 per cent. Probably one-half the savings banks in my State are only paying 3½ per cent, and there have been substantial withdrawals. If it should happen that the next Liberty loan should carry a rate above 4 per cent there would be absolute peril to the whole institution, and there is no wonder that there is misapprehension in the minds of the depositors and in the minds of the men managing the banks.

Senator LODGE. Savings banks are in a different position from other banks, because they are all under very strict State laws, with strict limitations on their investments, and it is impossible for them under those laws to invest as other banks do, or lend as other banks do and get anything like the same amount of interest. Therefore their position is very different from that of any other institutions.

Secretary MCADOO. That was not the point I had in mind. I was speaking of encouraging expansions of credit, not so much with respect to the savings banks, but with respect to creating a piece of machinery which would offer a rate of interest so low that it would encourage people to borrow when they ought not to.

Senator LODGE. In the savings banks there is a vast amount of money which it is very important to safeguard.

Secretary MCADOO. I think it is highly important, and that was one of the purposes of this bill. It is necessary to create this institution because of the condition of the savings banks, as well as of other industries in the country. It is of great importance to the people of the United States, as well as to the operations of the Government itself, to preserve the soundness of financial conditions in the country. We must do that if we are to carry forward the great operations of the Government, and the object of this bill is to supply a method which is at once sound and sufficient.

Senator GALLINGER. As an illustration of conditions in my own State, showing what the banks are doing to promote production of food, which is very essential, they are loaning their money at 5 per cent to the farmers throughout the State, a low rate of interest as contrasted with that of some of the other banks.

Secretary MCADOO. Is that on mortgages, Senator?

Senator GALLINGER. On mortgages, 5 per cent.

Secretary MCADOO. As I have said, the duration of these advances is limited to 90 days, and the interest rate is required to be not less than 1 per cent in excess of the rate of discount on 90-day commercial paper prevailing at the Federal Reserve Bank in the district in which the borrowing institution is located. This provision will tend to restrict the borrowings of these institutions from the War Finance Corporation to cases in which the necessary funds shall not be obtainable through ordinary banking channels.

I may say that the purpose of this bill is not to preclude the borrowing between banks and trust companies, by one bank from another, in the usual way as they are doing now. It is only an additional facility. It is not intended to restrict, but to enlarge existing facilities.

It may be suggested that a loan to a savings bank is not an aid to any "war industry." It is however important for the protection of

the whole financial and industrial fabric that these institutions, which hold the savings of the working people, should be able promptly to obtain cash with which to meet any demands that may be made upon them, without sacrificing sound investment securities under possibly abnormal market conditions. If for any reason the necessary funds should not be obtainable through the ordinary banking channels, then the War Finance Corporation would be in position to make the necessary advances. It would unquestionably have a most far-reaching and detrimental effect upon the "war industries," as well as others, if solvent institutions of this character should not be able to obtain funds to meet their obligations, without sacrificing needlessly the securities they hold.

Senator STONE. You speak of savings banks and securities. You furnish them with credit, without sacrificing certain classes of securities. How would that apply to insurance companies?

Secretary MCADOO. They would be in the same position to get relief from the War Finance Corporation; they could do the same thing; it covers them as well.

Senator THOMAS. They labor under the same limitations as the savings banks.

Secretary MCADOO. Where an insurance company had bought the bonds of a war industry it could get relief.

Senator STONE. It is a fact, I think generally understood, that a great number of insurance companies and savings banks own large numbers of railroad securities. I think it is very important that they be protected to prevent any collapse along that line.

Secretary MCADOO. They can borrow upon railroad securities, Senator. Certainly there is nothing more important than the railroads and transportation at this time, so that there would be no difficulty in that direction.

Senator STONE. I was just wondering whether the bill is broad enough to cover them.

Secretary MCADOO. Yes; it is broad enough.

Advances to savings banks are to be made not only for the protection of these institutions themselves and the savings of the working classes, many of whom are themselves engaged in war industries, but for the protection of the community from the shock and financial disturbance which would unquestionably result if these institutions because of abnormal conditions should be unable to meet promptly the demands of their depositors. Any such financial disturbance might seriously embarrass the borrowing operations of the Government.

In ordinary times, current deposits in savings banks are in excess of withdrawals, but as every effort is now being made to induce the investment of savings in Government securities, deposits in savings banks will probably be less than they otherwise would be. Savings bank depositors have, I understand, been discouraged from withdrawing deposits for investment in Government bonds, but there will always be withdrawals for one reason or another and in some communities at least, there has been a net loss of deposits. So far no embarrassment has resulted, but, if continued, an enforced sale of securities to meet the demands of depositors might result. Furthermore, as most savings banks do not pay more than 4 per cent, the

falling off in deposits would probably be accentuated if the Government should at any time offer bonds at a higher rate than 4 per cent, for that would probably have the effect of inducing withdrawals for investment in Government securities, no matter how much the practice might be discouraged.

Senator GALLINGER. As a matter of fact, a large proportion only pays 3½ per cent instead of 4 per cent. Would it not be well to state that, as many of them pay a less rate?

Secretary MCADOO. I shall be glad to adopt the correction, Senator. I was speaking more with respect to the general situation and not with respect to specific localities, as to savings banks.

The proposed act safeguards the savings banks by providing a method by which they may obtain loans on these securities, instead of having them thrust upon the market. The War Finance Corporation will not, however, make such advances unless they are amply secured, but will stand ready to lend prompt assistance when needed, upon the security required.

The corporation is authorized (subdivision (*d*)) to make advances in exceptional cases to war industries "upon such terms and upon the security of such bonds, notes, or other obligations, and subject to such rules and regulations as may be prescribed by the board of directors of the corporation, with the approval of the Secretary of the Treasury." This provision is intended to give the corporation power to render direct assistance to "war industries" without the intervention or obligation of any bank. The assistance which may be rendered through the banks which I have already described is of course indirect.

This subdivision (*d*) is an emergency provision, so that direct assistance may be rendered in exceptional cases, where and when it is urgently needed, without compliance with the provisions of subdivisions (*b*) and (*c*). The corporation may call for additional collateral for any advances which it may make under any of these subdivisions (*a*), (*b*), or (*c*).

Senator GORE. Would that cover the farmers, Mr. Secretary?

Secretary MCADOO. Yes; I think it would.

The CHAIRMAN. You do not mean to say that would enable your board to lend to farmers?

Secretary MCADOO. The corporation could, I think, in cases where it was clearly manifest that they could not get relief through banks, and there were exceptional circumstances.

The CHAIRMAN. I was under the impression that it means that the farmers' obligations deposited with banks would be accepted as security.

Secretary MCADOO. That is also true. If a bank should make a loan to a farmer the War Finance Corporation could make an advance to the bank based on such loan. This is an indirect assistance to the farmer, but the bill is also broad enough to cover a direct advance to the farmer in exceptional cases. It is conceivable that some exceptional case might arise where even a farmer who was producing some essential for the war might not be able to get funds otherwise than from the corporation. In such case he might apply to the corporation.

The CHAIRMAN. I am glad to know that is your construction of that.

Senator STONE. You work through the regional reserve banks, in general. Can you connect the farmer's banks with this?

Secretary MCADOO. Why, certainly, we can use any agency we please.

Senator LODGE. You do not propose that this corporation should convert itself into a land bank?

Secretary MCADOO. No, sir. The farmers are well cared for by the recent action of Congress in supplementing the land banks, giving the Secretary of the Treasury the power to buy up to $200,000,000 of land-bank bonds.

Senator STONE. The land banks ought to have some access to these relief funds.

Senator SMITH. There has just been made a specific provision for land banks to take care of them to the extent of about $100,000,000.

Secretary MCADOO. The land banks have been provided for by authority from Congress, which permits the Secretary of the Treasury to buy $100,000,000 of land-bank bonds this year and $100,000,000 next year. If we expend $100,000,000 this year in purchases of land-bank bonds secured by farm mortgages the land banks will have ample opportunity to take care of the farmer.

Senator MCCUMBER. If this is extended to land matters, I think you would have to increase your capital about ten times.

Secretary MCADOO. It is not intended to do that, Senator. This bill says in exceptional cases.

Senator TOWNSEND. Can you imagine an exceptional case where a farmer might get money from this corporation?

Secretary MCADOO. No, sir; I can not visualize one.

Senator SMITH. You certainly do not mean that this institution is to make real estate loans to farms or anybody else?

Secretary MCADOO. No, sir; it is not intended to do any such thing. This provision relates purely to exceptional cases which must be conclusively shown to be so, to the satisfaction of this corporation.

The CHAIRMAN. If a farmer borrows from a bank and gives his note as security with collaterals, that bank can use that farmer's note and collaterals in borrowing money from this corporation?

Secretary MCADOO. It can; yes.

The CHAIRMAN. There would be no doubt about your right to loan on that?

Secretary MCADOO. I think it could be done.

Senator SMITH. But there is a better and easier place for the farmer to get his money. First, his note which he can take to the Federal reserve bank, and if he wants a long loan we provide it for him in the farm-loan measure, and it is inconceivable that he would come to you, because he has been furnished better agencies for the use of his credit.

Senator STONE. If a farmer is not engaged in a war industry, I would like to know who is.

Senator TOWNSEND. I was wondering what the emergency could be that would cause a farmer to go to this corporation.

Senator GORE. I heard Dr. Stockdridge of Georgia say the other day that the interest on loans to farmers in banks not members of the Federal reserve system was 24 per cent.

The CHAIRMAN. Oh, I do not believe that.

Senator GORE. He is the editor of a farm paper in Atlanta, and he said he thought the average in nonfederal reserve banks was 24 per cent.

Senator SMITH. There are not many farmers borrowing money in Georgia now.

Senator MCCUMBER. Suppose the loan banks should say that, even with the hundred million which we have provided, there are four or five hundred million dollars of applications for loans by farmers for which they are ready to give their notes and mortgages, and they should come to the Government and say, "We need this, and we can not supply this demand," under this bill would funds be furnished to those regional or farm banks to loan and to take care of their bonds, whereby they may furnish money to the farmers? If it covers that, you have got a pretty broad field, and I think, it is wholly inadequate.

Secretary MCADOO. As a matter of fact, Senator, this bill can not be adequate for every demand that may be made. You could not construct any bill that would take care of everything.

Senator MCCUMBER. I do not think it should cover that at all.

Senator MCADOO. It was not intended specifically to cover that situation, because we have covered the mortgage part of it through the Federal land banks, and this bill is not designed specifically to take care of those cases.

Senator GALLINGER. In view of the instrumentalities provided by Congress to take care of the farmers, would it not be well to leave out that exceptional provision?

Secretary MCADOO. I think not, Senator, because there are other matters relating to necessary developments for war purposes where this may be a very necessary power to exercise, and we should provide for the intelligent exercise of that power. This provision also furnishes, I think, a desirable substitute for the advance to contractors now being made through the War Department to which I have already referred. I think the farmers are very well cared for under the Federal Reserve Act, and under the farm-loan system, and especially under this new provision which has been made for the purchase of land-bank bonds by the Treasury; this bill was not intended primarily to cover such cases, because we think we have provided relief in another way. But I am frank to say that under the broad provisions of the bill—and they must be broad—there may be exceptional cases, and I think this corporation should consider any exceptional and meritorious case, where relief could not be gotten otherwise. In such cases, I think, this corporation should extend credit under the safeguards imposed by the bill.

Senator LODGE. Does this corporation have the right to take mortgages?

Secretary MCADOO. You mean take direct mortgages?

Senator LODGE. Yes.

Secretary MCADOO. No; it can make an advance to a bank upon a note secured by a mortgage on real estate, but such note must be indorsed by the bank.

Senator LODGE. It can not make an original loan on a mortgage?

Secretary MCADOO. No; only in those exceptional cases where aid is extended directly to a war industry.

Senator SMITH. Simply as a collateral security, if the bank has a note secured by real estate.

Senator LODGE. I am speaking of this corporation, as an original proposition, lending money to an individual on a real-estate mortgage.

Secretary MCADOO. No, sir; it is not intended to make direct loans on mortgage security, but it may possibly do so in the exceptional cases to which I have referred.

Senator SMITH. There is not any such provision in the bill.

Senator GALLINGER. Before you proceed, I beg to inquire if you will have objection to placing this in permanent form to be printed?

Secretary MCADOO. Not at all, sir.

Senator GALLINGER. Because it would be of great importance to send all over the country.

Secretary MCADOO. I intended that it should be so used, Senator.

The corporation may (subdivision (e)) buy, subscribe for, and deal in bonds and obligations of the United States to such extent as the Secretary of the Treasury may from time to time determine. Much has been said about the market price of Liberty bonds and the subject has received careful study. Following is a quotation from the last annual report of the Secretary of the Treasury:

> The man who subscribes for a Government bond, and is advertised as a patriot for doing so, is not a patriot if he immediately sells that bond on the market when he does not imperatively need the money. It is not mere subscription to a bond that helps the Government; it is the actual purchase of the bond and the keeping of the bond that really helps. The people must save and invest in Government bonds. It is by actually lending money to the Government and not by merely promising it and shifting the load to some one else that the citizen really helps in this great time. If loans are made to the Government and bonds are taken therefor, the lender is supposed to deny himself something which releases in turn a demand on the vital supplies or stores of the country and puts the Government in position to buy the supplies thus released and to furnish them to our armies and navies. But if the lender immediately sells his bonds, relieves himself of the obligation to save vital supplies, and goes on wasting them, he does his country a grievous injury and hurts himself as well.
>
> I want to make it clear that there is no desire on the part of the Government to prevent or to interfere with freedom of legitimate trading in Government bonds—that is, trading in good faith.

The only sound and sure way to protect the market price of Government bonds is to teach the people to save so that they may become true investors in bonds and not merely subscribers for bonds. Yet there will be on every issue subscribers who find themselves unable to pay for their bonds or through necessity, misfortune, or otherwise are obliged to sell them. And there will always be those, few in number I am glad to believe, whose patriotism is of the surface sort and who take the credit of appearing as subscribers but are unwilling to make the necessary sacrifices to enable them to become permanent investors in the bonds. Last, and least, are those sympathizers with the enemy who deliberately sell their bonds with a view to the injury that they may do to the credit of the United States. I have studied with interest various measures which have been introduced in Congress and plans which have been presented to me for preventing Liberty Bonds from going below par. Most of these, I am sorry to say, have been, though very well meant, ill considered and calculated to destroy the success of the Government's financial plans. Any pro-

hibition upon the sale of Liberty Bonds would restrict subscriptions to such an extent as to jeopardize the success of future loans, and would be an act of bad faith toward those who have subscribed to the past loans and may be unable to hold their bonds. Any attempt to peg the price of Liberty Bonds at par would be unwise and subject to legitimate criticism as turning the Government's long-term 20 or 25 or 30 year bonds into demand obligations.

The only way in which that could be done would be for the Government to stand ready to redeem them at par at any time. The purpose of borrowing on time by the Government is exactly the same purpose which animates the manufacturer or merchant to borrow for a definite period in reference to his needs with a view to paying back the obligation at maturity, and the man who lends the money has no right to expect a borrower to pay it back in advance upon his demand at any time. And yet many people have the idea that the Government, because it borrows their money for 10 or 20 years, or whatever period it may be, and agrees to pay it back at maturity at par with interest meanwhile at the stipulated rate, must stand ready to respond to their demand and redeem the bonds before maturity at par, merely because they want it.

Senator LODGE. That would be impossible.

Secretary MCADOO. It would be impossible.

Senator LODGE. Do you not think the great mass of the bond holders will hold their bonds in order to get the full payment at maturity?

Secretary MCADOO. The great mass of the purchasers of Liberty bonds not only are buying them with a view to holding them primarialy because they are a good investment, but also because they patriotically want to help the Government; and I must say I have been immensely gratified with the splendid spirit shown by the people throughout the United States in buying Government bonds. I think I may say that out of the last two Liberty loans, when we sold over five billion eight hundred million dollars of bonds, there probably has not been resold up to date in the market more than one hundred millions of those bonds. Gov. Harding, am I right?

Mr. HARDING. I think so.

Secretary MCADOO. If the Government attempted to make only demand loans, it would not be possible to pay them, and we should put ourselves in position to face some extraordinary calamity. If the Government attempted to pay those loans on demand it might be bankrupted. Then, again, I think that if you undertook to peg the market at par you would encourage people to turn their bonds back to the Government when they get a little tired of holding them. Those people are not sufficiently informed about the importance of holding on as long as they can, and if they find that they can turn them back at par they would do so quicker, whereas if they find that they may be penalized for selling before maturity they may not be so anxious to sell.

Practically to attempt to maintain Government bonds at par involves the idea of issuing interest-bearing currency. It is impossible to peg the price of $6,000,000,000 or $10,000,000,000 of any security. The price of Government bonds will fluctuate as the price of other securities fluctuates. The man who holds on to his bonds and now watches

calmly a downward variation in the price of his bonds, will see the time come when the variation will be the other way and his bonds will sell at a premium. It is highly desirable that violent and unnecessary fluctuations in price should be avoided and that all possible measures should be taken to stabilize the price of Liberty bonds. The War Finance Corporation would be able, I believe, to stabilize to a large extent the price of Liberty bonds. It is well known that a comparatively small buying power will not only discourage those speculatively or viciously disposed persons who might desire deliberately to depress the price of Government bonds but would furnish added impetus to any upward movement in the price. This plan is along the lines of the plans adopted in European countries whereby sinking funds or specific appropriations are made for the purchase of bonds with the same object in view, and is better than any of them, I think, because the Government itself is removed from the transaction.

The purpose I have in view, under this subdivision (e) of the proposed act, is simply to permit this corporation to act in any circumstances that may develop, to such an extent as may seem wise in steadying the market for Government bonds. I say, if in the judgment of the board of directors, such an operation were wise. My own judgment is that no effort ought to be made on any large scale to maintain the price of Government bonds. But there may be times when it will be of very great value to have some means through which we could steady the situation.

Senator TOWNSEND. Have you indicated what means could be employed to do that?

Secretary MCADOO. The corporation will have the power, Senator, to buy and to sell Government bonds, so that if at any time it is deemed desirable to go on the market and buy some Government bonds it could do so, and sell them again. It is intended to be merely a stabilizing power, and is not for any other purpose.

The corporation is also empowered (subdivision f) to issue its own bonds or notes or obligations. The word "notes," which is used in the bill, has been very much misunderstood. It has been said that this corporation was going to issue bank notes to circulate as currency. That, of course, is most emphatically not the case. I suggest that the bill be changed by the substitution of the word "bonds" for "notes" in this subdivision, so as to avoid that misunderstanding. I shall refer to what the bill calls notes as bonds.

Senator LODGE. Those notes, of course, are not legal tender?

Secretary MCADOO. Of course not, and they are not currency.

The CHAIRMAN. Those are simply the notes of a corporation. The Government of the United States is not responsible.

Secretary MCADOO. No. The bonds of the war finance corporation may be used as collateral to the notes of a member bank, and the notes of the member bank will be eligible for rediscount in a Federal reserve bank. I want to make it entirely clear that the bonds of the war finance corporation are not themselves eligible for rediscount by Federal reserve banks.

Senator PENROSE. What kind of notes? Time notes?

Secretary MCADOO. The corporation will, of course, not issue any demand notes. The bill specifically provides that notes or bonds

issued by the corporation must mature in not less than one year nor more than five years

Senator PENROSE. Demand notes?

Secretary MCADOO. No; they would not be demand notes, Senator. That would not facilitate its operation; that would do just the wrong thing.

Senator MCCUMBER You anticipate that this corporation would borrow money, do you?

Secretary MCADOO. This corporation would primarily be a lender of money, but for this purpose it is authorized to borrow on its own bonds for not less than one year nor more than five years.

Senator MCCUMBER. It issues its notes for something——

Secretary MCADOO. The effect of it would be this: Suppose the First National Bank of Fargo loaned to a corporation engaged in a war industry or manufacturing or creating supplies of any kind needed for the war, and suppose that corporation gave collateral security of such character as to satisfy the First National Bank of Fargo. Now, suppose that the obligation so acquired by the First National Bank of Fargo is ineligible for rediscount in the Federal Reserve Bank of Minneapolis, and suppose the First National Bank of Fargo wants to realize something on that obligation because the pressure on it for funds is very great. In other words, that it wants to rediscount that note. As it stands now, it would go to some one of its correspondent banks, in New York or some other part of the country. Suppose the correspondents say, "We can not take your note; it is not eligible for rediscount in a Federal reserve bank." If the War Finance Corporation were in existence the First National Bank could go to it and offer the note of the war industry. The War Finance Corporation could take that note, indorsed by the First National Bank of Fargo, and advance money on it. It has $500,000,000 in capital to operate with and it may raise additional funds through the sale of its bonds, or, if it has not the money and does not wish to sell its bonds just then, it can say to the First National Bank of Fargo, "We will take this note and lend you $75,000 if you will take our bonds in payment of that loan." If this proposition should be acceptable, the First National Bank of Fargo would thereupon indorse the note of the war industry and deliver the note and its collateral to the War Finance Corporation and receive from the War Finance Corporation $75,000 in the bonds of the War Finance Corporation. If the First National Bank of Fargo should require cash, it would execute its own note for $75,000 to the Federal Reserve Bank of Minneapolis, pledging the bonds of the War Finance Corporation as collateral, or it could sell the bonds in the market.

Senator MCCUMBER. It could either give its bonds to the First National Bank, or money or its note, and the First National Bank could then use that note with the Federal reserve bank?

Secretary MCADOO. Yes; as collateral security for its own note.

Mr. WARBURG. It must be at least for one year.

Senator MCCUMBER. You use the words "bonds" or "notes."

Secretary MCADOO. The use of the word "notes" as applied to the securities which the corporation is authorized to issue has led to confusion; they should be called bonds.

Senator LODGE. The notes are promissory.

The CHAIRMAN. It might be well to put that in.

Senator MCCUMBER. I do not see any occasion for promissory notes if it would give its bond. It would not give a promissory note. I do not well understand any condition under which this corporation which you are to create would give its promissory note.

Secretary MCADOO. It would only do this. Suppose it had loaned its entire working capital of $500,000,000, so that it did not have money to lend. Suppose that there were one hundred millions of additional loans that it ought to make to banks or to war industries, those loans being collaterally secured by notes that were absolutely good. Now, in that event, having no money, it could issue a hundred millions of its own bonds.

Senator MCCUMBER. Bonds, but not promissory notes.

Secretary MCADOO. A short-term bond. It is sometimes called a note, especially when it is not secured by mortgage, but I think it is simpler to call it a bond.

Senator MCCUMBER. I can not see the necessity of using another term. A promissory note is not a bond.

Secretary MCADOO. I want to make it absolutely clear that the power of the corporation to issue its own bonds does not mean any power whatever to issue currency. It is a means of providing funds in addition to the proceeds of the sale of its stock to the United States, by the issue and sale of its own securities. The amount of the corporation's bond issues outstanding at any one time is limited to eight times the paid-in capital stock (i. e., a maximum issue, in case all the stock is actually paid in, of $4,000,000,000).

It could never issue and have outstanding over $4,000,000,000 of bonds and then only against security which is at least 25 per cent greater than the amount of its own bonds, plus all of the $500,000,000 capital stock.

Senator MCCUMBER. Thus widening the opportunity for borrowing?

Secretary MCADOO. Exactly. These bonds which the war finance corporation may issue are required to run for not less than one year nor more than five years. They may bear such rate or rates of interest and may be made redeemable at the option of the corporation, as the board of directors, with the approval of the Secretary of the Treasury, may determine. These bonds are given a first and paramount floating charge upon the assets of the corporation, and are not to be otherwise secured—for the corporation is specifically prohibited from placing any lien or mortgage upon its property.

The purpose of these provisions is to make any bonds it issues a paramount floating lien or mortgage, because the corporation is prohibited from creating any mortgage or other charge which would have priority over the bonds. Whatever bonds the corporation issues are protected by a blanket obligation and a paramount lien upon all the assets of the war finanace corporation.

Senator STONE. Would there be objection to putting in a provision fixing the amount—I mean a minimum or maximum amount—to be written into these obligations—these securities or bonds or whatever you may call them—that this corporation issues?

Secretary McADOO. It is provided here that it shall in no event issue bonds secured by mortgage upon its assets.

Senator STONE. You want to issue a hundred millions, or whatever it may be. How would it be issued? In large denominations?

Secretary McADOO. You must leave the denominations to the corporation to determine, Senator, just as you do with Government bonds.

Senator STONE. Possibly; but I had this thought, whether this credit in small denominations would not be available for a good many circulating purposes, although not currency.

Secretary McADOO. I do not see how they could be.

Senator STONE. Not legal tender, but for the accommodation of communities. They are payable to the bearer.

Secretary McADOO. They would not be any more likely to circulate than a $50 or $100 Government bond.

Senator STONE. But you can not use a $100,000 bond for any such purpose.

Secretary McADOO. I think the denominations must be left to the corporation. Of course they must be made to meet the different needs of different banks or borrowers, but as they have a maturity of not less than one year, nor more than five, they could not be used as currency. The accruing interest would give them a changing value from day to day and make them quite inconvenient as a circulating medium.

I now want to take up another aspect of the bonds which may be issued by the War Finance Corporation. The Federal reserve banks are authorized, subject to the regulations of the Federal Reserve Board, to purchase, rediscount, and use paper secured by the bonds of the War Finance Corporation in the same manner and to the same extent that paper secured by bonds or notes of the United States not bearing the circulation privilege may be similarly used, purchased, and rediscounted. There are, however, two important exceptions to this statement. First, the Federal Reserve Board may require the Federal reserve banks to charge a higher discount rate on paper secured by the securities of the War Finance Corporation than on paper otherwise secured; and, second, the Federal Reserve Board may impose upon the Federal reserve banks a special interest charge in respect to Federal reserve notes issued against paper secured by the securities of the War Finance Corporation, which need not be applicable to Federal reserve notes otherwise secured.

These provisions are made in order to impose a special tax in effect upon Federal reserve notes circulated by the Federal reserve banks against paper secured by the bonds of this corporation, on the theory that it is an emergency measure, and so obtain the retirement as quickly as possible of any Federal reserve note issues that may from time to time be issued against the security of this class of paper. That is a mere matter of machinery that is easily worked out.

It is believed that the right to impose this higher discount rate and this special interest charge will enable the Federal Reserve Board to exercise a beneficial control over the issue of Federal reserve notes based on bank paper secured by the corporation's bonds. All existing provisions of law, not inconsistent with the provisions of the bill, are expressly made applicable to Federal reserve notes issued against

paper secured by the bonds of the corporation. The Federal reserve banks are also authorized to make advances to member banks secured by bonds of the War Finance Corporation.

There has been some criticism of the bill on the idea that in some way or other there will be currency inflation. Any idea of currency inflation must result from a misconception as to the bonds issued by the corporation, for there is no danger that such securities will cause inflation through an undue expansion of the circulating medium of the country.

It must always be remembered that the Federal Reserve Board has absolute control over the issue of Federal reserve notes. That board would undoubtedly be quick to restrict the issue of such notes if at any future time the danger of inflation appeared.

I think I have made it clear that the bonds of the War Finance Corporation are not intended to circulate, though they may of course be bought and sold like other ordinary corporate bonds or notes. Moreover, they can not directly be made the basis of Federal reserve note issues. In this respect they stand in the same situation as Liberty bonds.

If a member bank makes a loan to a customer for the purpose of enabling the customer to buy either Liberty bonds or bonds of the War Finance Corporation, taking the customer's note, eligible for rediscount in other respects also, the member bank may indorse and rediscount that not at the Federal reserve bank of its district. The Federal reserve bank, having discounted the note indorsed by the member bank may, with the approval of the Federal Reserve Board, in turn take out Federal reserve circulation upon the security of such note. As the note indorsed by the member bank must mature in not more than 90 days the Federal reserve notes issued against it must then be either retired or other security must be found therefor. Federal reserve note issues will contract or expand responsively to the contraction or expansion of the demands for credit upon the member banks.

The Federal reserve act requires that there shall always be maintained for Federal reserve notes a "gold cover" of at least 40 per cent.

Section 7. This section prohibits the sale or offering for sale or for subscription by any person, firm, corporation, or association, of any issue of securities in excess of $100,000, or any part of any such issue, issued after the approval of the act, except under rules and regulations prescribed by the corporation, with the approval of the Secretary of the Treasury, and under licenses from the corporation in case such rules and regulations shall so require. I may say that amount may be increased; I am not wedded to the $100,000 limit. We can make it larger if it should seem wise. The $100,000 limitation was fixed with the idea of establishing a limitation which shall be sufficiently large so that the corporation shall not be burdened to an impracticable extent with the duty of passing upon minor issues of securities, and which shall also be sufficiently small so that the uncontrolled issue of a very large aggregate amount of securities shall not be permitted.

The difficulty has been to get the provisions of the bill sufficiently broad to bring under the regulation of the corporation the issue of all

securities which it was desirable that the corporation should regulate, and at the same time not include a vast number of transactions which do not involve capital expenditures.

It is not intended that the corporation shall exercise any regulation over securities already issued, for new issues of securities make the principal demands upon capital seeking investment. The prohibition against selling or the offering for sale of securities therefore applies only to securities issued after the approval of the act. No buying or selling of existing securities in or out of any stock exchange is prohibited. Though the terms of the bill are broad enough to prohibit any sale of securities issued after the date of the approval of the act, whether or not they have once been licensed, it is probable that the corporation will in most instances find it desirable in licensing any issue of securities at the same time to license any resales of such securities. This arrangement would mean that once the sale of an issue of securities had been licensed all further trading in such issue should be entirely free. It may be that the regulations issued by the corporation will require a notation of the license to be made upon the securities themselves. In that case, it would give those securities a greater market availability. The bill is not intended to prohibit, or in any way to interefere with, the ordinary bank borrowings for the purpose of transactions in the ordinary course of business. Any other borrowings in excess of $100,000 evidenced by bonds, notes, or other obligations are subject to the prohibitions of the bill against the sale or offering for sale of securities without a license from the corporation, if the regulations established by the corporation shall require such a license. Let me say that the corporation does not have to issue regulations and licenses. It is only in a position to do so if any exigency develops where it is desirable that the matter should be regulated by a formal license.

In order that there may be no embarrassment, while the operations of the corporation are being gotten underway, to corporations, having pressing capital requirements such for example as maturing obligations, in making arrangements to meet these requirements, the bill provides that this section shall not take effect until the rules and regulations under which the corporation will exercise its functions shall have been duly prescribed.

The provisions of section 7 of the bill do not apply to any railroads which may be in the possession and control of the President. These, of course, could not be subject to the provisions of the bill.

Section 8. This section prescribes a fine of $5,000 or imprisonment for four years, or both, as the penalty for violation of any of the provisions of the act.

Section 9. The surplus earnings of the corporation not required for its operations are to be accumulated in a reserve fund to be invested, under the direction of the Secretary of the Treasury, in bonds, notes, or certificates of indebtedness of the United States. This section also provides for the liquidation of the corporation, beginning six months after the termination of the war. The proceeds of such liquidation are, of course, to be paid over to the United States.

This corporation will undoubtedly be profitable because it can not lose money under the plan devised.

Section 10. The corporation is to be exempt from taxation except that its real estate is to be subject to local taxation in like manner as

other real estate. The securities of the corporation are to be subject only to like taxation as the bonds of the second Liberty loan.

Sections 11, 12, and 13. These sections define the term "securities," reserve the right of amendment, and provide that the invalidity of any portion of the act declared invalid by any court of competent jurisdiction shall not invalidate it as a whole.

That is all of my statement.

Senator LODGE. I only want to say this, Mr. Chairman, that I hope the Secretary will be able to come again before the committee, because there is one thing in the bill, it seems to me, that is of very great importance, and that is in regard to the nonessential industries, which I think is a rather unfortunate term. I should like to have an opportunity to make some inquiries of the Secretary in regard to that.

The CHAIRMAN. We will arrange with the Secretary for him to appear again at a convenient time.

Mr. SECRETARY, in regard to this inflation, I want to see if I understand you. Your scheme does not contemplate in any way enlarging or changing the powers of the Federal Reserve Board with reference to issuing its notes, but it simply provides a scheme by which that board may lend money upon securities upon which it is not now permitted to loan?

Secretary MCADOO. Yes. It simply enlarges the base of eligible securities upon which Federal reserve banks may lend.

Senator MCCUMBER. And thereby will necessarily increase the service.

The CHAIRMAN. We will now take a recess until 2.30, when we will hear Mr. Warburg and Mr. Harding.

(Thereupon, at 12.45 o'clock p. m., the committee took a recess until 2.30 o'clock p. m.)

AFTER RECESS.

At 2.30 o'clock p. m. the committee reassembled pursuant to the taking of recess.

The CHAIRMAN. Mr. Harding, will you kindly make your statement first?

STATEMENT OF HON. WILLIAM P. G. HARDING, GOVERNOR, FEDERAL RESERVE BOARD.

Mr. HARDING. Mr. Chairman, it has been arranged that I shall deal only with certain features of the bill, and that Mr. Warburg will discuss the matter of the licensing of the sale of securities and the restrictions of unnecessary capital expenditures. I suggest, therefore, that any questions you may wish to ask regarding securities and capital issues be reserved for Mr. Warburg, who is better prepared to discuss that feature of the bill here.

I think it is only fair to say, also that Mr. Warburg and myself are here to-day in our individual capacities. This particular bill has never been sent to the Federal Reserve Board for its consideration, and the board, therefore, has not taken any stand regarding it, either favorable or otherwise. The board, however, is interested in the objects which the bill seeks to attain, and is impressed with the importance of some measure of relief for the securities market.

Some time ago the board adopted a resolution putting itself on record that some governmental intervention was necessary in order to take care of this situation, and it threw out the same idea in its annual report to Congress, which was submitted about two weeks ago.

The CHAIRMAN. Do you mind giving us the benefit of your individual opinion as to the necessity for legislation of this sort?

Mr. HARDING. I thing that legislation providing for Government aid is absolutely essential. The board has been urged repeatedly during the last four or five months to take some step to protect the holders of securities, as well as to liberalize its definition of eligible paper. The savings bank situation has especially been brought to the board's attention. The savings banks as a rule can not come into the Federal Reserve System. Mutuals, having no capital, are excluded under the Federal reserve act as it stands to-day. Their securities are of such character as to render them ineligible as collateral for loans with Federal reserve banks. This applies to a greater or less degree to the investments not only of savings banks but to those of State banks, trust companies, and national banks as well.

There has been another development. The Federal reserve act defines very clearly what is eligible paper. There are two essential factors which determine the eligibility of paper. One is the time that the paper has to run; in the case of commercial paper, not longer than ninety days, and, in the case of agricultural paper or paper based on live stock, not longer than six months. Time is one factor. The other factor which governs the eligibility of paper is the use to which the proceeds of the paper have been applied. Those two things determine the eligibility of unsecured paper.

The act goes further and expressly bars "merely" investments, such as stocks, bonds, and securities other than United States bonds. As the Federal Reserve System has been developed, and as the banks have found that certain classes of paper are eligible with the Federal reserve bank, and that they could go ahead and discount paper of that character very freely, at the same time keeping their portfolios in liquid shape by reason of being able to rediscount this paper with Federal reserve banks, a premium, so to speak, has been put upon "eligible" paper, and the banks more and more have gone into the field of commercial paper and bankers' acceptance. We find that several trust companies which never had bought any paper, never had done any commercial business, in the last six months have gone into the commercial field. There is a distinct preference to-day for eligible commercial paper. Every bank prefers to have a large proportion of bills discounted, eligible for rediscount with a Federal reserve bank, thus assuring availability of funds whenever needed.

In this connection I might say that the new issues of Government bonds have had the effect, naturally, of destroying, to a large extent, the securities market. It follows that when the United States Government has issued a very large amount of 4 per cent bonds, an amount greater than the investment market can readily absorb, the ordinary securities market is necessarily paralyzed; and the larger the Government issues and the higher the rate the greater will be the depression of the ordinary investment market. The deposits of

savings banks especially go into these Government bonds. Savings bank depositors have invested freely in Government bonds. As these depositors have taken bonds either for investment purposes or from a patriotic sense of duty their balances are drawn down. Ordinarily when savings banks deposits decline the banks sell securities, but just now the savings banks have no adequate market in which they can dispose of securities. Regardless of intrinsic values, when banks sell railroad or industrial bonds in the present circumstances they do so at a ruinous sacrifice, and the larger the offerings are the worse the situation becomes. So it has been becoming more and more manifest for some time past that there are only two plans to be considered. One is to broaden the base of eligibility and to permit the discount by Federal reserve banks of notes secured by ordinary industrial or railroad bonds, and the other is to adopt some plan providing for direct governmental intervention or aid.

Senator Calder some time ago introduced a bill which provided for the rediscount at Federal reserve banks of notes secured by bonds as collateral, but the board has never been in favor of this plan. One of the underlying principles of the Federal reserve act is the strictly commercial and purely liquid character of its assets. The Federal reserve note is secured by gold or by gold plus commercial paper, and the paper pledged to secure the Federal reserve note ought to be self-liquidating. The injection into the Federal Reserve System of a vast volume of paper secured by miscellaneous industrial and railroad bonds would bring about a radical change in the Federal Reserve System and would alter the characteristic of the Federal reserve note. The Federal reserve note at present is an elastic currency. A currency, to be elastic, must have the ability to contract automatically as well as to expand. There can be no elasticity if the movement is all in one direction. It must work both ways in response to the varying requirements of trade and commerce.

With the vast expenditures for war purposes, the great financial operations of the Government, enormous issues of Treasury obligations, and the activity in certain lines of business, it is evident that more currency is needed for purposes of circulation than was the case two or three years ago.

Senator LODGE. I think the circulation per capita last year, as I remember, increased $9. Is that a large increase?

Mr. HARDING. That is a large increase, but is less than the increase of the gold holdings of the country since January, 1915.

The necessity for a bill of this kind, as I see it, lies in the fact that as between the Government financing on a large scale and the operations of the Federal reserve act in putting a practical premium on eligible commercial paper, the securities market has been so seriously affected that holders of securities have no adequate protection. Then, as the Secretary of the Treasury explained this morning, there are a great many firms and corporations which are engaged in essential war industries or in other industries which are needed for the public welfare which must find some way of meeting their requirements for new capital. Public utility corporations and other transportation enterprises are obliged to float new securities from time to time, as well as to make arrangements for renewing issues

about to mature, and there is just now no investment market for them to appeal to.

The logic of the situation, therefore, as I see it is that, the present conditions having been created by the necessities of the Government, it is only fair that the Treasury should divert a part of the funds secured from the people out of the sale of bonds to the relief of those very people to whom the Government must look in order to keep up the uninterrupted flow of money which it will need to realize from future issues of bonds. If we throttle these industries and paralyze the public utility companies and create a general financial depression, how can we possibly expect to float any more large bond issues successfully?

Senator LODGE. Mr. Harding, right there, how are you going to draw the line between essential and nonessential industries?

Mr. HARDING. I should like to leave this for Mr. Warburg to discuss.

Senator LODGE. How are you going to distinguish between an essential and a nonessential industry?

Mr. HARDING. If you are willing, I should prefer that you let Mr. Warburg discuss this question.

Senator LODGE. I wanted to have you distinguish between essential and nonessential industries, and to state whether it was your opinion that the nonessential industry should slowly be strangled?

Mr. HARDING. As far as the Federal Reserve Board is concerned, it does not seek to strangle any industry, but simply to give advice and do what it can to facilitate the operation of those which it regards as absolutely essential. Of course if a man is able to finance himself or his industry and business he can continue to operate regardless of the essential or nonessential character of his industry.

Senator SMOOT. Is it the purpose of this bill, in your opinion, to deny capital to what you may call nonessential war industries? and if you answer that affimatively, then I would like to know just what the definition is of nonessential war industries. Then, as Senator Lodge has just suggested, there comes the next question, How does such currency affect the general industrial situation of the United States; and proceeding from that, how will it affect the revenue of the United States? Now that is a subject that is of importance.

Mr. HARDING. I would very much prefer not to discuss that. You see the board has a committee, of which Mr. Warburg is chairman, known as the Capital Issues Committee, and that committee has made a very careful study of all these questions during the last two months, and I think it will be very much better to have Mr. Warburg discuss these matters.

But if we wish to promote the prosperity of the country and to keep industries going, both the essential and the nonessential, I think we must have some provision for aid which this bill is designed to give. In my opinion the passage of a bill providing for a corporation with a capital of $500,000,000 for the purpose of making loans which have in ordinary times been absorbed in the securities market, would, from the very beginning, inspire a feeling of confidence and relief. I doubt very much if there will be such a demand for loans from this corporation as some seem to anticipate, because the general knowledge that there is an agency which can effectively

supplement and rehabilitate the securities market will tend to stabilize the situation and will make all of those who have been in the habit of appealing to the securities market feel more comfortable and confident.

Senator GALLINGER. I think there is no doubt on that point, that if there is some place where they can get relief it will create confidence.

Mr. HARDING. Then suppose that there is a heavy demand for accomodations of this sort and that in the course of time this whole $500,000,000 is exhausted, then we should consider the bonds or notes which the bill authorizes the War Finance Corporation to issue. I would like to discuss this feature for a moment.

Senator GALLINGER. Before you go to that, you have expressed yourself on a lot of things, and I would like to ask you what is your view as to the rate of interest the savings banks should pay, they themselves paying 3½ and 4 per cent, to get this money?

Mr. HARDING. The bill provides that rates shall be not less than 1 per cent more than the Federal reserve bank rate for 90-day commercial paper. Rates of interest paid by banks on deposits should have no bearing upon the rate of interest paid for these special accommodations. If rates for these accommodations are made too low, or if it is made too easy for banks to borrow, the facilities of the War Finance Corporation will be overtaxed, and the process would lead to unnecessary credit inflation.

Senator GALLINGER. It would lead to inflation, then?

Senator STONE. They would be compelled to pay the rate at which they loan that money out. They would only be compelled to borrow in case of emergency or pressure.

Mr. HARDING. In times of crisis, when banks need to realize upon securities, the question is one of getting funds, and whether the rate is 5 per cent or 6 per cent is of minor consequence.

Assuming that the War Finance Corporation loans its entire capital of $500,000,000, the bill provides that the corporation can issue its own bonds or obligations. As I understand it the resulting situation would be that a borrower, instead of getting cash from the War Finance Corporation, would receive its obligations, which the bill provides can be used by Federal reserve banks just as Government bonds are used, and which are nontaxable to the same extent that Government bonds are exempt. It seems, therefore, that the holder of these obligations could use them as collateral for loans or could sell them on the market to just as good an advantage as the holder of commercial paper or bankers' acceptances can, and if they fall into the hands of Federal reserve banks they do so only as collateral to a note which has the indorsement of a member bank. Of course it follows that the volume of eligible paper would be increased should the corporation issue its obligations of this character.

Senator GORE. There would be no danger of inflation in that direction?

Mr. HARDING. The bill does not appear to make it mandatory upon the Federal reserve banks to deal in these notes or obligations, but provides that they may be dealt in by Federal reserve banks in the same manner and to the same extent as bonds or notes of the United States not bearing the circulation privilege, and that Federal reserve banks shall be authorized, subject to the regulation of the Fed-

eral Reserve Board, to rediscount and purchase paper and make advances secured by such obligation in the same manner and to the same extent and at the same rates or at such higher rates as the Federal Reserve Board may approve as they may purchase or rediscount paper or make advances secured by such bonds or notes of the United States under authority of the Federal reserve act.

The bill also provides that whenever Federal reserve notes are issued against the security of such paper the Federal Reserve Board may make a special interest charge on such notes which, in the discretion of the board, need not be applicable to other Federal reserve notes which may from time to time be issued and outstanding.

This does not make two distinct issues of Federal reserve notes. At the present time Federal reserve notes may be secured wholly by gold or in part by gold and in part by commercial paper, and the holder has no way of knowing in which way they are secured. If the Federal reserve note should be secured partly by gold and commercial paper and partly by obligations of the new finance corporation, the Federal Reserve Board would, of course, know exactly the proportions, and the bill proposes to give the board power to impose a special tax upon that portion of the outstanding note issue which is secured by obligations of the War Finance Corporation. This special tax would tend automatically to advance the rates of interest or discounts on the obligations of the corporation, and would check any tendency to excessive credits. The Aldrich-Vreeland Act provided for a graduated tax upon outstanding notes, and the maximum tax was sufficiently high as to force their retirement.

Senator SMOOT. In other words, by the tax you would force the retirement of these obligations?

Senator MCCUMBER. The power is there in the bill to inflate the currency $4,000,000,000.

Senator STONE. They could not, because the Federal reserve banks could only issue $2,500,000,000, and that would not be $4,000,000,000.

Mr. HARDING. The normal minimum reserve required against Federal reserve note issues is 40 per cent, and the normal minimum reserve against deposits is 35 per cent. The Federal reserve banks have approximately $1,700,000,000 of gold reserves. Taking into account the present note issues of about $1,200,000,000 and reserve deposits of about $1,400,000,000, it will be seen that the free gold held by the banks is by no means sufficient to support an additional issue of notes for anything like $4,000,000,000.

Senator MCCUMBER. Four billion dollars at least can be used as a basis for issuing additional currency.

Mr. HARDING. Any bill of this sort, to be effective, must of necessity be broad and sweeping in its terms. Reliance should be placed in the good sense and judgment of those charged with its administration.

Senator STONE. Answering Senator McCumber, this bill does not authorize Federal reserve banks to issue paper; it merely provides for the eligibility of paper.

Mr. HARDING. It only adds to the possible volume of paper against which notes may be issued. It does not give the Federal reserve banks any increased note-issue powers.

Senator STONE. That would not tend to an inflation of the currency.

STATEMENT OF HON. PAUL M. WARBURG, VICE GOVERNOR, FEDERAL RESERVE BOARD.

Mr. WARBURG. Secretary McAdoo and Gov. Harding have so fully covered the field that there is very little for me to add. I am glad, however, to avail myself of this opportunity to state before this committee that, speaking for myself, I am heartily in accord with the objects and aims of this bill and its general plan. There is no doubt but that some organ as here proposed is imperatively required at this time. We have created an emergency machinery for commercial requirements in the Federal reserve act; but this is the only important financial country that does not provide any emergency machinery for the purpose of dealing with securities (stocks or bonds). The mere fact that this lack exists creates in times of stress and war a feeling of uncertainty which is a decided weakening of the national strength. What is proposed here is destined to remedy in part this defect and to cope with some of the difficulties and problems caused by the Government's financial operations—the relief will be both actual and in its effect on the general sentiment.

To illustrate: I think there is a great deal of psychology in the situation, so far as savings banks are concerned. When once they know that they can get relief they probably will not need it so much. I do not believe that we will ever be called upon to issue anything like obligations amounting to $4,000,000.000 of this corporation, but the power is there, and that is a tremendous benefit and protection for the general situation.

I understood that it is your wish that I should address myself to the question of licensing securities.

The CHAIRMAN. Mr. Warburg, before you go to that, Secretary McAdoo stated this morning that somebody, at some meeting, in some way or other, had outlined the English method of meeting a similar situation over there that this bill is intended to meet here. Would it take you long to go into that, and to outline the English method?

Mr. WARBURG. I brought here a pamphlet of 6 pages which is marked "Exhibits A and B" that was written by Mr. Basil P. Blackett, financial adviser to the British Embassy. When this question of controlling the issue of securities was first discussed there was organized in New York a committee to make a report about the subject. They invited Mr. Blackett to give them a short report on what had been done in England, and he wrote them this very short paper, which contains a discussion of the English system.

Senator MCCUMBER. Why not have that inserted in the minutes?

The CHAIRMAN. Let us have that inserted.

(The pamphlet, Exhibit A, referred to is here printed in full, as follows:)

EXHIBIT A.

[Confidential. Memorandum for Mr. Curtis, Federal Reserve Bank, New York City.]

NEW YORK, *August 6, 1917.*

GOVERNMENT CONTROL OF NEW CAPITAL ISSUES IN GREAT BRITAIN.

The control of new issues of capital by the British Government started with the regulations for the reopening of the stock exchange which, after being closed from the end of July, 1914, was reopened at the beginning of Jan-

uary, 1915, subject to special conditions agreed upon between the British treasury and the committee of the London Stock Exchange and accepted by the other stock exchanges in the United Kingdom. In accordance with this agreement, the committee of the stock exchange bound itself and the members of the stock exchange to deal in stock and shares subject strictly to certain regulations approved by the British treasury and made binding upon the stock exchange. These regulations were not statutory, but the penalty of failure to observe them in any particular was expulsion from the stock exchange of any member found guilty of contravening the regulations. Particular regulations dealing with new issues of capital laid it down that no dealings should be allowed on the stock exchange in any securities issued subsequent to the date of the regulation, unless the issue of such securities had been first approved by the British treasury.

A committee known as the "capital issues committee" was appointed by the chancellor of the exchequer to examine all applications for approval of new issues and to recommend to the treasury whether or not approval should be given for such issue. The original members of this committee were:

Lord St. Alwyn (formerly Sir Michael Hicks Beach) who had been chancellor of the exchequer from 1896 to 1902, chairman.

Lord Cunliffe, governor of the Bank of England.

Sir Thomas Whittaker, M. P. (Liberal).

Sir Frederick Banbury, M. P. (Unionist).

Sir George Barnes, assistant secretary of the board of trade, with Mr. B. P. Blackett as secretary.

On the death of Lord St. Aldwyn a year later, Lord Cunliffe became chairman, and Mr. Gaspard Farrer, of Baring Bros., was added to the committee. Mr. Blackett resigned the secretaryship in July, 1915, and the representative of the board of trade has changed more than once.

It was soon found that applications for permission to make new issues were being received not merely in respect of important new issues such as would expect to obtain a quotation on the stock exchange but also in respect of issues of shares and debentures by public and private companies of all sorts. It was decided that it was desirable as far as possible to prevent any new issue taking place without Treasury approval, although the penalty of being unable to obtain dealings on the stock exchange was of little or no importance in many cases. There have undoubtedly been a certain number of new issues by private companies and small public companies, such as a company to run an individual cinematograph theater, but, with the assistance of the bankers and of the vast majority of outside brokers and financial houses, practically speaking, no new issue of the least importance has taken place since January, 1915, without Treasury approval. The number of applications dealt with up to the end of June, 1917, was something like 15,000. In practice, the Treasury has accepted in every case the recommendation of the committee, and it is generally understood in the city of London that an appeal against the decision of the committee is simply an appeal for reconsideration by the same committee and that the chancellor of the exchequer will not interfere. This has been of considerable importance from the parliamentary point of view, because the chancellor of the exchequer has been able to shelter himself behind the opinion of the representative city committee against complaints, which have been numerous, of the action of the treasury in regard to specific cases.

The procedure adopted by the committee has been, broadly speaking, to deal with the less important cases, which form the vast majority of the total, in a somewhat summary fashion, and to refuse applications for new issues unless and until a fairly good case has been made out, either—

(1) That the new issue is necessary or desirable from the point of view of the successful prosecution of the war; or—

(2) That to refuse permission would involve the complete loss of capital already expended or at any rate would involve a very heavy loss of previously expended capital.

The more important cases may be divided into two categories:

(1) A disappearing category; cases in which leave is asked for the issue of capital on behalf of foreign or colonial governments or corporations. In these cases there has been an increasing tendency to insist on the funds required being obtained outside the United Kingdom—that is, occasionally in Holland or elsewhere, but usually in the United States of America.

(2) Cases where the issue is alleged to be necessary for the prosecution of the war, that is, usually in connection with some firm engaged on Government

contracts. In these cases, arrangements have been perfected for obtaining the advice of the Government department or Government departments concerned, i. e., the war office, Admiralty, Board of Trade, and, above all, the ministry of munitions; and sometimes oher departments. The decision in such cases, subject to technical questions on the method of finance, is nearly always dependent on the view taken by the responsible Government department as to the desirability of the issue from the point of view of securing necessary supplies.

I should perhaps add a third category, namely, renewals of maturing debentures, etc., which are, as a rule, granted without much examination, unless there is an obvious opportunity for referring the application to a neutral money market.

The issue of loans by the Governments of the British Dominions of Provinces and States of the British Dominions, or by the Government of India, has been reserved by the Treasury, and dealt with in connection with war finance without any recommendation being required from the capital issues committee.

It may be stated broadly that after a transition period covering the year 1915, no new issues of any sort, except for renewal purposes, has been approved unless for the purpose of the successful prosecution of the war.

Soon after the capital issues committee was constituted, the question of capital expenditures and borrowings by local authorities in Great Britain came under the consideration of the committee. In January, 1915, many of the local authorities had not yet got over the idea which was so prevalent at the beginning of the war that Government and municipal capital expenditure would be necessary or desirable for the purpose of preventing unemployment. Local authorities in Great Britain finance their capital expenditure.

(1) By the issue of stock on the market.

(2) By the issue of 6-month or 1-year bills.

(3) By the issue of mortgages on the security of the rates which are sold from day to day over the country for amounts of £100, or even, in a few cases, of £10. These mortgages usually run three or five years in the first instance, but they are frequently left after the original term has expired at call, and are very popular because they are not subject, as a rule, to market fluctuations.

The capital issues committee as such did not deal in detail with the question of new capital expenditure by local authorities, but recommended the Treasury to take the question up with a view to preventing new capital expenditure as far as possible. The town clerks and treasurers of most of the large cities were interviewed at the Treasury, and it was urged upon them that in order to conserve the capital and labor of the country for the prosecution of the war further capital expenditure by local authorities should be prevented as far as poss'ble. A circular drawn up by the Treasury was issued in March, 1915, by the local government board, informing all local authorities that the sanction of the local government board would not be given for new capital expenditure in any cases where such sanction was necessary by law, unless the local authority could prove to the satisfaction of the Treasury that such expenditure was essential for the prosecution of the war, e. g., extension of electric power plants owned by municipal corporations, or in the interests of public health, e. g., water supply in cases where there was a serious danger of shortage. This circular covered capital expenditure by most of the smaller authorities, but did not cover capital expenditure on a large scale by many of the large cities, whose authority for such expenditure is dependent upon acts of Parliament already obtained. In practice, however, pressure from the Treasury and the local government board and cooperation by the treasurers and town clerks has sufficed in this matter, even in respect of contracts already let. For example, there was a contract involving over 1,000,000 sterling for the erection of a new county hall by the London County Council.

Arrangements have been made with the contractors to bring the work to an end for the period of the war as soon as a stage has been reached where a building can be left unfinished without the work already done being wasted. As a result, capital expenditure by the local authorities has practically ceased, and one incidental effect has been that considerable sums accrued on the sinking funds established in connection with capital expenditure by the local authorities have become available for investment in war loans, owing to the closing down of the channels previously available for the investment of such moneys, namely, capital expenditure by the local authority itself, since some of the authorities were in the habit of using their sinking funds to finance their new capital expenditures, or capital expenditure by other local authorities,

since it was a favorite practice for one corporation to lend its sinking fund moneys to another corporation.

In dealing with the closing down of work upon contracts in the course of progress, considerable difficulty was naturally met with in reaching a fair settlement as between the local authority and the contractor. This difficulty was, however, overcome, first by the issue of a circular by the Treasury to the banks, asking them not to give accommodation for new building works of any kind, unless these were proved to be necessary in connection with the prosecution of the war, and finally by the issue of a regulation under the defense of the realm act by the ministry of munitions making it necessary for the sanction of the ministry to be obtained for any expenditure on new buildings in excess of £500. This regulation was justified by the difficulties met with by the ministry of munitions in providing labor for the building of new munitions works and for the operations of munition factories generally, in various districts where the existence of large building contracts in the course of progress was found to be leading to serious shortage of labor for munitions purposes.

Apart from this regulation under the defense of the realm act in regard to building work, the only legislation of which I am aware, remotely connected with the control of new issues of capital, is a section in an act which has the effect of extending the period during which "ancient lights" and similar rights and franchises are kept alive for an extra period corresponding to the period during which new building work has been prohibited by reason of the war; and a stock clause in all new acts of Parliament giving new borrowing power to municipal corporations, railway companies, etc., under which the exercise of any new borrowing powers conferred by such act is made subject, for the period of the war and 12 months thereafter to the sanctions of the treasury.

Apart from these special cases, the whole control by the Government of new issues of capital has been based on cooperative arrangements with bodies such as the stock exchange, the association of clearing houses, bankers, etc.

BASIL P. BLACKETT.

(The pamphlet Exhibit B referred to is here printed in full, as follows:)

EXHIBIT B.

New capital issues on the London market, exclusive of vendors' shares and reborrowing operations.

[In thousands of pounds.]

	1913	1914	1915	1916	6 months to June 30, 1917.
British Government loans	.....	332,500	614,251	554,071	1,038,483
Colonial government loans	26,270	38,674	17,385	6,500	6,453
Colonial corporations	14,811	7,754	350	.....	.....
Indian and colonial rails	14.941	23,378	3,965	.....	.....
Total items 2-4	56,031	69,806	21,700	6,500	6,453
Foreign government loans	26,158	18,333	38,450	15,000	.....
Foreign corporations	6,958	10,606	.....	.....	.....
Foreign railways	17,411	12,795	2,940	384	.....
American railways	10,627	1,416	.....	.....	.....
Total items 5-8	61,154	43,150	41,390	15,384	.....
British municipal loans	920	3,096	.....	495	.....
British railways	1,019	2,161	3,294	1,679	.....
Electric light, power, telegraph, etc	6,916	6,746	547	102	200
Tramways and omnibus	4,710	5,869	432	.....	100
Gas and water	422	699	20	16	.....
Total items 11-13	12,048	13,314	999	118	300

New capital issues on the London market, etc.—Continued.

	1913	1914	1915	1916	6 months to June 30, 1917.
Mining companies	3,329	2,677	21	23	.....
Exploration and financial	7,424	5,099	45	.....	.....
Breweries and distilleries	24	911	.....	.....	.....
Merchants, etc	433	280	.....	102	.....
Manufacturing	10,895	7,957	1,808	1,449	78
Stores and trading	2,216	2,263	.....	.....	.....
Estate and land	4,042	3,002	25	.....	.....
Rubber	1,276	718	153	16	3
Oil	5,265	3,408	22	1,574	.....
Iron, coal, steel, etc	6,419	3,673	163	1,275	.....
Motors	1,528	1,559	130	381	332
Hotels, theaters, etc	538	803	79	7	.....
Patents	2,188	396	.....	27	.....
Docks and shipping	3,265	7,209	580	800	.....
Banks and insurance	4,494	3,480	266	275	1,500
Miscellaneous	12,029	5,060	316	1,260	30
Total items, 14-29	65,365	48,495	3,608	7,189	1,943
Grand total	196,537	512,522	685,242	585,436	1,047,179
Destination of new capital:					
United Kingdom	35,951	364,420	621,140	.....	.....
British Possessions	76,137	80,940	22,289	.....	.....
Foreign countries	84,449	67,162	41,912	.....	.....
Total	196,537	512,522	685,242	.....	.....

Mr. WARBURG. What they did in England was this: They organized a capital issues committee, of which the chairman was the chancellor of the exchequer, Lord Cunliffe, governor of the Bank of England, Sir Thomas Whittaker, Sir Frederick Banbury, members of Parliament, and Sir George Barnes, assistant secretary of the Board of Trade. These five men formed this committee, and this Mr. Blackett, who is now here, was the secretary. It was, as a matter of law, a voluntary organization. As a matter of fact, however, it acted at once as a law. Nobody was permitted to issue any securities for public sale without the previous approval of the committee. They did not provide a limit as inserted in the war finance corporation bill of $100,000, or as the Federal Reserve Board's capital issue committee now provides a limit of $500,000 for corporations and $250,000 for municipal issues.

Senator GORE. What was that last?

Mr. WARBURG. $250,000 for municipal issues.

Senator GORE. They limit municipal issues also?

Mr. WARBURG. Oh, yes. They need it most. The British committee simply provided that anybody who wanted to issue securities had to get the O. K. of this committee.

Senator LODGE. Was this a law?

Mr. WARBURG. No; it was voluntary, but it acted at once as a law, and the result was a surprising one. The statistics are here. As a matter of fact they went so far that practically every issue of new securities stopped, municipal issues stopped, even where commitments had been made, and the Government stepped in and indemnified people where it was necessary in order to stop building operations already contracted for.

I will give you the figures here. They are interesting.

In 1913 the grand total of colonial issues was 56,000,000.

Senator SMOOT. Sterling?

Mr. WARBURG. Sterling; yes, sir. In 1916 it was 6,500,000.

It is interesting to note that the municipal loans were, in 1913, 12,000,000, in 1914, 13,000,000, and they went down, in 1916, to 118,000. So they practically stopped.

Senator STONE. All that is in sterling?

Mr. WARBURG. That is all in sterling; yes, sir.

Then the other corporations, mining companies, manufacturing companies, iron, coal, steel, and so on, went down from £65,000,000 to £7,000,000 in 1916.

So they went at it in a most drastic way, and, I believe, with a most fortunate result, because England has managed to keep her banking system less inflated than any other country, and, at the same time, was able to place a tremendous amount of Government bonds. Of course they had us, who stood by them, but even then they could not have done it unless they had closed the door tight in dealing with every development that was not absolutely essential. Of course at first that sounds very drastic and unwise, but it does not strike me to be so. Because, after all, the problem is, in the first line, one of men, of labor and goods, and service, and, in the second line, only one of money. Money is of no value to the Government if labor and goods can not be bought therewith. As long as we are building houses that are unnecessary, and take the material and take the men for that, we are not only taking the savings, which should be available for the benefit of the Government, away, but we also take the goods and the men, which is much more important. With your permission I might tell you in a few moments what we have been doing here in dealing with this same problem.

Secretary McAdoo at first put out a statement asking everybody to consult with him before issuing securities. The response was so immediate that he found, after a while, that it was more than he himself could well handle without an organization especially created for that purpose and he asked the Federal Reserve Board whether it would not undertake this for the country. We agreed to do so with a great deal of trepidation. It is a thankless task, and there is a great deal of responsibility connected with it. We finally took it, and the chairmanship of that committee fell to my lot, and that is why I am answering these questions.

We organized an advisory council of three. We asked three men, the ablest and most experienced we could get from the various sections of the country—Mr. Allen B. Forbes, from New York, Mr. F. H. Goff, from Cleveland, and Mr. Henry C. Flower, from Kansas City. These three men came her and served in the capacity of our advisors. We secured Mr. Bradley W. Palmer, of Boston, as our counsel. All these men serve as volunteers without compensation.

What we do at present is simply upon request to express an opinion as to whether or not, after careful examination, securities which are to be offered are compatible with the public interest, and that public interest we consider from two points of view. One is the general public welfare, what is necessary for the health and the strength of the people, and the other is the interest of the Government in the prosecution of the war. We have organized local committees at Federal reserve bank points and have invited the most prominent

experts to serve in an advisory capacity in their districts. We have taken bankers, public utility men, and manufacturers—as a rule a mixture of all three—and we have organized out of those a standing commitee of five men, which consists of the chairman of the Federal reserve bank, the governor of the Federal reserve bank, and three other men, as described, and to those men we refer, wherever advice is necessary, the application for such local investigation as is necessary. They give us their best opinion. After that our Washington advisory committee passes upon it, and then the committee of three of the board finally renders its opinion. I have a copy of a letter giving such opinion here. It reads as follows:

Having inquired into the purpose of the issue above described, we are of opinion that the sale of the said bonds is not incompatible with the interest of the United States.

This finding constitutes no approval of such issue as regards its merits, security, or legality in any respect.

In any public offer or advertisement of the said issue this letter must be incorporated in full.

That last paragraph was for the purpose of avoiding some houses using our approval as appearing to recommend the security as such. We do not pass, of course, upon the intrinsic merits of any security.

Senator STONE. What would you do if you disapprove it?

Mr. WARBURG. That would be simply that it is incompatible, in our opinion.

That does not legally obligate anybody. These people come to us in an entirely voluntary capacity. It has been generally advertised that there is a body which looks into the question of whether a thing is in the interest of the United States or not, and there is a common agreement now among the important houses that they will not give any aid to anything except that which has this expression of approval on the part of the committee. The New York Stock Exchange committee has given notice that it will not grant quotations for new issues except as approved by our committee, and I have no doubt that the Investment Bankers' Association and the American Bankers' Association will cooperate in a similar manner. But it is simply a voluntary matter.

The CHAIRMAN. It would be a pretty difficult matter to float bond issues which did not have that approval?

Mr. WARBURG. Yes, so far as the important houses are concerned.

Senator MCCUMBER. You actually issue letters declaring that a certain obligation is incompatible with the public interest?

Mr. WARBURG. Oh, yes.

Senator MCCUMBER. And have issued them?

Mr. WARBURG. Oh, yes.

Senator MCCUMBER. And the effect of that would be to destroy the proposition?

Mr. WARBURG. It would not destroy the proposition. It might seriously interfere with the sale at present. There are a great many smaller issues, particularly, which are not submitted to us, which are offered by bankers, which we do not reach at all at this time.

To illustrate—and I do not think I ought to go into the name of the city—a very important city, only a few days ago, advertised for the sale of $1,750.000 of bonds, and the house asked us to pass upon it. We acted as fast as we could. We found that they were water

bonds, electric bonds, park bonds, and sewer bonds. Well, we went into this thing, and the director of finance came to us and discussed it with us, and finally agreed with us that it was not absolutely necessary for them to have all that money. We found there it was not necessary for them to complete their parks at that time. Very often it is found that developments are not so immediately necessary that they could not wait for six months or a year.

In other cases we find that the improvement is needed very badly, or the project has been contracted for, or it has progressed so far that it is better to complete it; in such cases we granted applications. But, as stated before, we have found cases where an agreement was reached that the expenditure was not necessary at this time, and where they could get on, by crowding themselves for six months, and they were willing not to issue the securities. The same with road bonds.

Senator STONE. Is that done voluntarily, without any law?

Mr. WARBURG. Yes, sir.

Senator STONE. You can not enforce it?

Mr. WARBURG. We have no authority.

Senator STONE. No authority at all? It is entirely a voluntary affair?

Senator SMOOT. The same as is in effect in England to-day?

Mr. WARBURG. Yes, sir.

The CHAIRMAN. You do influence the investing public in such a way that these bonds are not successful on the market?

Mr. WARBURG. I do not think we have quite reached the point where we could say that, but the investment houses know it, and on the whole they all are pretty good citizens, and when they know that that is what is required for the benefit of the country, I think they will cooperate. That is our theory. Our method of procedure is, wherever we can, to find out what are the requirements of the Government on the one hand, and to investigate locally the necessity for the issue. To illustrate, the Secretary of Agriculture was asked about the building of roads, and he is in complete accord with what we are trying to bring about. Roads must of course be kept under repair, but for the present the building of highways should stop where possible except where they are of military importance just now, or of great economic importance. Where there is a possibility of bringing goods to market, food stuffs, particularly, or where they now can not be produced owing to a lack of public roads and where the department advises us that that is the case, we say all right. Wherever we would be advised by the department involved in the case that it is an absolute necessity, we would approve the issue.

Senator GALLINGER. On that point, I observe that this is simply advisory.

Mr. WARBURG. Yes.

Senator GALLINGER. Do you interfere with the project in a State of the building of new roads where the legislature has appropriated $1,000,000 to build good roads in a State? Would you feel at liberty to advise that that was not a good thing to do?

Mr. WARBURG. If they asked us, and upon investigation we found the expenditure untimely, we certainly would, and we feel that the States and municipalities are the ones where the greatest good can

be done. Some mayors are most appreciative that we are backing them up. It is difficult for these men at home simply to decline to go into public work when the appropriation has been made. But when we are backing them, they find themselves pretty well protected, and can much better afford to do it. Of course we can not do anything at this time but express an opinion. It the State wants to proceed with its sale, and succeeds in finding a bond house that will buy the bonds, we can not prevent it. There is no authority of law, but the more the work of our committee will be known, I think the better will our voluntary authority be accepted in the matter.

Senator GALLINGER. Do you attempt to investigate each individual case?

Mr. WARBURG. Yes.

Senator GALLINGER. As an illustration, take a manufacturing concern that may not be very strong financially, that wants to issue bonds, and if they have not that privilege they will have to go out of business; do you investigate to see exactly what the effect of your advice will be?

Mr. WARBURG. Let me say, that as to renewals and refundings, we generally take the attitude that they have to be done. We are not knowingly going to take any action that would break anybody's neck. We can not do that. But where our action has a strong effect is in dealing with new expenditures, which are not compatible with the public interest.

Senator GALLINGER. You deal, then, with new enterprises rather than with renewals of capital to carry on the business?

Mr. WARBURG. Oh, yes. Where it is a question of renewals, as a general principle we feel that we ought to pass those, unless we found that there had been extraordinary profits which might have been used to pay off some of these maturing obligations. But as a general principle we would say they have to be renewed. The same way about refunding of banking debts, where they have been incurred previously, prior to February 1, we would say yes, they have to be renewed. On the whole, I think a body of this kind would always have the tendency to be very considerate. It involves a terrific responsibility. It is not an easy matter to say to anybody that he should not extend his plant or go on with his regular business.

Senator MCCUMBER. Do you confine that to those public matters?

Mr. WARBURG. Oh, no.

Senator MCCUMBER. Not only public utilities, but private enterprises as well?

Mr. WARBURG. Private enterprises just as well.

Senator MCCUMBER. Take an automobile concern. A number of people get together and try to manufacture automobiles, and want several million dollars of credit. You consider whether that money, to be gotten around the country, had better be used for other purposes?

Mr. WARBURG. Yes.

The CHAIRMAN. Now, then, is it probable that you can do this very same work in the Federal Reserve Board if it is made obligatory instead of advisory? The Secretary would have to have some agency to do that work for him other than this corporation. You might

possibly exercise about the same functions that you now perform by this committee?

Mr. WARBURG. Yes.

The CHAIRMAN. And you would advise the corporation, and whatever you would do would become binding upon the corporation?

Mr. WARBURG. No, the final word in that case would be with the corporation.

Senator GORE. Now, Mr. Warburg, according to Mr. Harding's statement and the Secretary's statement this morning the primary and paramount object of this bill is to provide capital and credit for enterprises manufacturing war supplies, on the theory that the bond and security market has largely been destroyed, on account of large issues of Government liberty loans. Now I understand, though, that the object of this last section is to prohibit people from floating and selling bonds or securities, even though there is no bond or security market. It looks to me like those positions are a little incompatible with each other.

Mr. WARBURG. No, I do not think it could be said that there is absolutely no security market. There is a market particularly for such securities as are being offered for in smaller amounts and where commissions are being paid for the placing, and where the interest rates are attractive and the security is good.

Senator GORE. Of course there is some market left.

Mr. WARBURG. But it is, as you said, a very bad market.

Senator SMOOT. It has been virtually destroyed.

Mr. WARBURG. Whatever there is ought to be retained for those corporations or municipalities or for the Government, that need it, in the public interest.

Senator GORE. Have you been able to make any survey upon which you can base an estimate as to the requirement of the essential industries and the requirements of the nonessential industries?

Mr. WARBURG. I do not think it is possible to determine that.

Senator GORE. Could you furnish a schedule showing the ordinary requirements of State governments, city and other local governments, and also the ordinary requirements of industrial organizations for credit in the year past?

Mr. WARBURG. I think I could show you what has matured this year, and that would give you about as good an indication as anything.

Senator GORE. I was going to ask you also, in that connection, as to the amount annually required for renewals and refundings.

Mr. WARBURG. I think I have some figures here that would show that. Of course these are estimated figures. They are not quite exact.

Senator GORE. Yes.

Mr. WARBURG. The total of maturities for this year amount to $799,000,000.

Senator GORE. That is in the year 1918?

Mr. WARBURG. Yes, sir; in the year 1918. Of that, $214,000,000 are railroad, $224,000,000 are public utilities, $182,000,000 are industrials, $120,000,000 are State, county, and municipals, and $58,000,000 are companies in Canada, Cuba, and Mexico, a total of about $800,000,000. I will insert the entire table (Exhibit C).

(The table referred to is here printed in full, as follows:)

EXHIBIT C.

Securities of railroads, public utilities, industrials, and municipals maturing from Jan. 1, 1918, to Dec. 31, 1918.

	United States only.					Companies in Canada, Cuba, and Mexico.	Grand total.
	Railroads.	Public utilities.	Industrials.	State, county, and municipals.	Total.		
January	$17,452,877	$7,663,688	$15,792,723	$28,149,987	$69,059,275	$6,831,500	$75,890,775
February	9,421,167	59,301,065	25,229,775	3,201,191	97,153,198	643,000	97,796,198
March	4,602,240	9,247,750	22,554,325	6,480,620	42,884,935	719,500	43,604,435
April	57,205,820	11,875,400	17,436,692	6,535,934	93,053,846	434,000	93,487,846
May	30,102,248	21,879,150	21,114,092	13,189,688	86,285,178	696,000	86,981,178
June	9,102,781	11,406,250	10,037,942	11,752,481	42,299,454	90,000	42,389,454
July	24,750,813	79,061,000	8,285,442	19,822,057	131,919,312	7,561,530	139,480,842
August	6,990,709	7,143,400	10,072,942	7,371,291	31,578,342	12,503,000	44,081,342
September	20,498,711	4,450,950	6,162,167	5,658,731	36,770,559	10,590,500	47,361,059
October	6,088,344	7,386,000	8,385,442	3,645,961	25,505,747	10,629,000	36,134,747
November	24,211,948	2,409,750	7,124,656	3,290,729	37,037,083	4,020,000	41,057,083
December	3,763,781	2,304,280	30,441,562	11,575,301	48,084,924	3,497,500	51,582,424
Total	214,191,439	224,128,083	182,637,760	120,673,971	741,631,853	58,215,530	799,847,383

NOTE.—Figures for railroads, public utilities, and industrials were obtained from Moody's Manual of Securities, maturing Jan. 1, 1918–Dec. 31, 1919.

Figures for municipals were obtained from the Financial and Commercial Chronicle, State and city section, Part I, comprising New England, Middle, and Central States, dated May 26, 1917, and Part II, the Western, Pacific, and Southern States and island possessions, dated November 24, 1917: these being the latest compilations available.

Of the railroad securities, $55,522,634, are equipment trust bonds, all or a substantial portion of which will presumably be taken care of through sinking funds created under the equipment trusts.

Senator LODGE. Those are for what year?

Mr. WARBURG. Maturities this year.

Senator GORE. You have no estimate of the probable new requirements?

Mr. WARBURG. That is impossible, Senator, because this is such an extraordinary year. The conditions are such that you can not guess at the requirements. You can not even approximate what they will be, and that is one of the reasons why I think we ought to have a large machinery that is able to take care of the unexpected that may come.

Senator GORE. You have no estimate for the last two or three years, even?

Mr. WARBURG. I have not got them here; no.

Senator GORE. If it is not too much trouble, I wish you would attach it to your statement when you revise it.

Mr. WARBURG. What is it you desire, Senator?

Senator GORE. The requirements of new capital during the last two or three years. You stated the renewals and refundings required for the year. I think if we had an estimate of the requirement of new capital in the last two or three years we could at least form some basis for an estimate.

Mr. WARBURG. I can furnish you that. (Exhibit D.)

(The figures referred to are here printed in full as follows:)

EXHIBIT D.

The best available figures showing the totals of financial issues in the United States exclusive of foreign loans, for the four years

prior to America's entry into the war, are as follows, in millions of dollars:

	Par value, 1913.	Par value, 1914.	Par value, 1915.	Par value, 1916.
CORPORATE FINANCING.				
Industrials	278.0	271.5	571.0	951.0
Utilities	453.5	346.0	324.0	542.0
Railroads	958.5	714.5	684.5	371.0
Total	1,690.0	1,332.0	1,579.5	1,864.0
STATE, COUNTY, AND MUNICIPAL FINANCING.				
Permanent loans [1]	403.2	474.1	488.0	445.2
Canadian loans	161.5	177.9	267.3	246.9
United States possessions	1.0	3.0	2.0	4.7
Total	565.7	655.0	757.3	696.8
Grand total	2,255.7	1,987.0	2,336.8	2,560.8
[1] NOTE.—Temporary loans were as follows	550.4	384.6	236.4	290.3

Senator SMOOT. It would be a mere guess.

Senator GORE. It would not be much of a guide, but it would afford the best basis we could get.

Mr. WARBURG. You would simply have a statement of what was issued for the year of new securities in stocks and bonds. It would have no bearing on what is required this year at all.

Senator STONE. You can not compare one with the other. What is done this year you will find was not done last year, and what will be done next year was not done this year.

Mr. WARBURG. We never spent anything like what we are spending now.

Senator TOWNSEND. Mr. Warburg, have you any data showing the net income of the country seeking new fields of investment?

Mr. WARBURG. That I have not.

Senator LODGE. Mr. Warburg, how do you draw the line between essential and nonessential industries?

Mr. WARBURG. Well, as a matter of strict theory, we think that can hardly be done. I think you have to be guided by what is common sense, I should say, when you come to make the examination and consider each case on its own merits. There are certain things which we all know we do not need and which can easily be dispensed with. When you come to the border line where it is really difficult to decide, you have to go to headquarters.

Senator GORE. England divides them into "most urgent," "urgent," and various other classes.

Senator LODGE. I understand as to new corporations, just starting, but as to existing business——

Mr. WARBURG (interposing). An existing business would proceed on its own basis. Whatever does not require new capital, even if it deals with articles that are not "essential," may proceed on the same basis as before. It will not be touched by us.

Senator LODGE. This is the distinction that I am trying to get at. For instance, you say essential to the prosecution of the war?

Mr. WARBURG. Yes.

Senator LODGE. Now, you take the street car system of an industrial town, which takes care of not only the town but the surrounding country. It can not possibly be said that that is essential to the prosecution of the war, yet to allow that public utility to break down might be to permit the disorganization of industry in that town.

Mr. WARBURG. I should say that we would never let it break down. The question that would come before us would be whether we should let it expand, and there, I think, the question would be, Is that new construction necessary for war work or essential to the health and welfare of the people.

Senator STONE. Senator Lodge, you spoke of the street railroads in the city.

Senator LODGE. Yes, sir.

Senator STONE. I happen to have a very pertinent case or illustration. There is a violent strike now that is going on in St. Louis. The whole street railway system of St. Louis is paralyzed. I am told—I have not asked the Secretary or these gentlemen—that Mr. McAdoo, as Director General of the Railroads, has been asked to take over, under his power, this street railway system in St. Louis.

Mr. HARDING. Because it was interfering with war production, the strike is interfering with war production. That is the basis.

Senator STONE. Primarily I assume that is the basis. Now he, I am told, has declined to do it. But that is neither here nor there. That is the thing Senator Lodge suggested.

Senator LODGE. That is what I had in mind, only I was looking at it solely from the financial basis, I was going on the assumption that that operates not directly on the prosecution of the war, yet it has been considered necessary to allow those to continue, and that it would be very unfortunate, in the time of war, to close those industries. Take the movies in a great city. Some people consider that those are educational institutions, but I put it on the other ground. Is it thought desirable that those places should be discouraged and depressed and are they to be treated as nonessentials and closed down?

Mr. WARBURG. I think possibly we are confusing two distinct things, the new expenditure of money and the operation of an existing industry. It is not a question of closing the movies or theaters, but when it would come before us it would be a question of whether a company should be permitted to offer $5,000,000 of bonds or stocks for the purpose of establishing new movies.

Senator LODGE. I did not mean that.

Mr. WARBURG. That is our problem.

Senator LODGE. Suppose they needed some money for necessary repairs and if they were refused the authority to make that loan they would have to close.

Mr. WARBURG. I think that is an entirely different proposition. Generally speaking, what is self-sustaining and proceeding with ordinary business expenditures would not come before us.

Senator LODGE. I use this illustration, because this is a distinction between essential and nonessential.

Mr. WARBURG. Our committee does not use that expression. We say: "Compatible with the public interest."

Senator LODGE. Is it not true that in a broad sense all legitimate industries are essential to the conduct of the war?

Mr. WARBURG. No, I think not.

Senator LODGE. People make money, which can be used for the payment of taxes.

Mr. WARBURG. No, sir, I would not say that.

Senator LODGE. I mean in a sense that is essential.

Mr. WARBURG. Very essential.

Senator LODGE. If we begin closing up industries and turning people out of their employment——

Mr. WARBURG (interposing). We could not, of course, close them up at all.

Senator LODGE. I know, but if they are refused credit they may find it impossible to live.

Mr. WARBURG. I think there are a great many industries that at this time should be closed up, and if there were some temporary disturbance or dislocation, rather, of labor and capital, in the long run it would be to the interest of the country at large.

Senator LODGE. It destroys savings and destroys taxable income, destroys the power to earn.

Mr. WARBURG. It puts it immediately somewhere else, Senator.

Senator LODGE. Well, does it?

Mr. WARBURG. May I just say again: That is not the thing that we would be dealing with, because we are not closing out existing industries but deal only with new issues. New money should go where it does the most good. It is a very large proposition, of course, and it can not be done in a rough-handed way.

Senator STONE. Take soda water, take coca cola——

Senator LODGE. And tobacco.

Senator STONE. Those are things that go into the trenches—tobacco and all that. But, here, while soda water is not essential to the prosecution of the war, suppose you have a great soda-water establishment or some one desires to build a new one.

Senator LODGE. Or industries that make farm machinery?

Senator STONE. The point I am getting at—and I am not doing this critically—I am trying to find out; I am giving what occurs to me as being a rather extreme case—evidently, to me, those are not essential war industries, such as I have named, but the new credit that they require will contribute largely to industry, will employ a great number of people and a great amount of capital, and they pay taxes—war-profits tax, income tax, and all of that. Now, I am just interested in knowing just what to draw this line and how you gentlemen will draw this line, and what, in your good judgment, the effect will be upon the industrial life of the country, the labor of the country, and the revenue of the Government.

Mr. WARBURG. Well, I think that ought to be clear. To begin with, we do not limit this word "essential" to war work, but we say "compatible or incompatible with the public interest." That means in the prosecution of the war and the general welfare of the country, of course. There is a great deal of latitude in that.

Senator LODGE. I want to get rid of that essential and nonessential

The CHAIRMAN. That is not incorporated in your letter.

Mr. WARBURG. No; in the letter we say "it is not incompatible with the public interest."

Senator SMOOT. There is another question that I wenat to ask you. You said several times that your idea is only to provide for new capital—new money. Do I understand that to be the case?

Mr. WARBURG. We pass only on that.

Senator GALLINGER. That is not denying it.

Mr. WARBURG. No.

Senator SMOOT. Supposing a case of this kind—and there are hundreds of them. Here is an electric-light plant. Fifteen years ago they issued bonds. The bonds fall due, as they were 15-year bonds, this year. Do I understand, now, that they are not to be assisted in case the original bondholders demand the payment of the bonds—that they can not receive assistance under this bill in order to secure the money to take up those bonds?

Mr. WARBURG. Oh, no; I did not say that. I did not say that at all.

Senator SMOOT. That is not what you said?

Mr. WARBURG. Pardon me. I was telling the committee what we are doing at this time—that is, our committee. Now, our committee has no money to spend. We are only asked what we consider a legitimate security issue. So the mere fact that it is a renewal would indicate that ordinarily the renewal would have to be carried on. The question of assistance would only arise in case of the new war finance corporation.

Senator SMOOT. I knew you had been discussing the question as to what you had been doing in the past, as to your approval or disapproval of the issuance of bonds.

Mr. WARBURG. Yes.

Senator SMOOT. That was only new capital, as I understood it.

Mr. WARBURG. Yes.

Senator SMOOT. But when the Senator from Missouri asked, in relation to these industries that are now in existence, whether they should be stopped, then I understood you to say you had nothing to do with the issue of bonds.

Mr. WARBURG. Senator, I am only discussing the question of the license at this time. I am not now discussing the question of what actual business the War Finance Corporation is going to do. We are simply discussing what is the basis of our judgment in passing upon applications for the issue of new securities, which, of course, will be one function of the future corporation.

Senator SMOOT. If an institution such as I cited had to raise money for the paying off of those bonds, and the bonds would amount to more than $100,000, there would be a new issue, and they would have to receive a license under this bill, and that is for money that is already spent, and it is for money to pay off an obligation. Now, do I understand that you would not handle that kind of a case?

Mr. WARBURG. If you address me as the new corporation?

Senator SMOOT. Yes, sir; I do.

Mr. WARBURG. Yes; we would handle it if the board of directors would find that this is a corporation which does a compatible business.

Senator LODGE. The Secretary of the Treasury stated here this morning that there was no intention of interfering with renewals;

that they were going to deal only with new capital; and he said that most explicitly. To deny them those renewals would wreck half the business of the country.

Senator SMOOT. That is just exactly why I wanted Mr. Warburg to say what his position was.

Mr. WARBURG. My position is that we would have to take care of renewals. Otherwise we would ruin industry.

Senator SMOOT. I know you will have to take care of them.

Suppose, Mr. Warburg, that this company writes to you to get a license, or to get permission to borrow money to refund its notes; how would you answer them in that case; in the case of such a concern as you say you have nothing to do with?

Mr. WARBUG. To-day?

Senator SMOOT. If this board were created, and you were a member of it, and this concern wrote you that they wanted to get $200,000 or whatever they needed to refund a debt that they owed, and it was not a war concern or making war material, but they should write you about it?

Mr. WARBURG. I think there might be cases where we might possibly have to say that we could not do anything for them. Of course, I am not authorized to speak for the corporation, and I can not but give my own views, but my feeling would be that if you take a very drastic case we might be obliged to say that we could not do anything for them.

Senator SMOOT. That is what I understood Mr. McAdoo to say. That is what I was trying to get from Mr. McAdoo this morning. I asked him that question, yet all through his paper that he read he had reference to war concerns and did not cover other concerns. Now, I was wondering if you should write a letter back such as you have read here, that that is incompatible with the general welfare, if it would not mean absolute ruin to that concern.

Mr. WARBURG. As a matter of fact they would find it probably very difficult to find money anyhow, would they not?

Senator SMOOT. They would not find it so difficult as they would if the Government of the United States put its stamp of disapproval on it.

Mr. WARBURG. Are you afraid that we would act as a wrecking party?

Senator MCCUMBER. We do not say that Mr. McAdoo would do that.

Mr. WARBURG. Of course, our primary concern, the primary concern of the Government must be, at this time, to keep everything going, including all these corporations that are organized. But when you go to the other extreme, that everything that comes, everything that has commercial paper, good, bad, and indifferent, can come to this corporation and say, "I want money" and get it, that cannot possibly be our view.

Senator TOWNSEND. Your voluntary organization which you are now, through which you attempt to advise, is not that working sufficiently well, without any legislation on the subject?

Mr. WARBURG. I should say it works well in dealing with large propositions, and I believe that we can gradually come closer down. We are dealing only with a minimum of $500,000 for corporations now, or $250,000 for municipalities. This is a very large problem.

and even where we have 12 banks and their branches all over the country it would be difficult to supervise and control all transactions involved. In England, of course, they have only some 40 banks. England is not moving as rapidly industrially as we are. We have a much more difficult proposition, no doubt. I suppose we could continue under this volunteer plan and exercise a very healthy influence. I doubt whether we could get quite as far as we could under this plan, because this is only a voluntary agreement. I would not be surprised if some people, having found out that we were not in favor of their issues, would go home and see whether they could not get around it some way or other.

Senator LODGE. I want to get at what I think I see is a very serious danger. We had a situation which arose, as I was informed, in connection with this coal or fuel business. In the extreme Northwest, in the States of Washington and Oregon, I am told by certain parties that they wanted to get permission to go on cutting timber, and they were told that they could go on getting out timber for the purpose of building ships, but they must not make any other lumber. Now, as I understand it, in making ships they necessarily cut off other lumber that is used in the building trade generally, for making frame houses for the inhabitants of that part of the country. That is not an essential war industry, but is it not terrible to stop an industry like that and say that is not an essential industry?

Mr. WARBURG. It does not appear to me quite clear that it would not be an essential industry.

Senator LODGE. I mean housing the people is not directly a war industry.

Mr. WARBURG. Still I think that the building of many houses is not necessary.

Senator LODGE. I am not speaking of building great houses. I am speaking of the frame houses people are building in that country.

Mr. WARBURG. They are not issuing securities.

Senator LODGE. Some of these sawmills sell securities, and they are very large concerns.

Mr. WARBURG. Are there not a great many sawmills in existence to-day that can supply that material? Is it necessary to establish new ones? It is the answer to that question which we would have to try to find. We have an application from Oklahoma. Somebody wanted to put up a new refinery for oil. We got in touch with the Department of the Interior, and the thing is being studied most carefully now. Is there sufficient oil available? Is the present capacity of refineries sufficient, or is it necessary to put up a new one? We are guided in that case and in all these cases by the final advice of those responsible in the matter. If for instance the Department of Agriculture would tell us to-day this is a road—and they are very conscientious about this—that ought to be built, that is what is going to guide us. And so if the department should say that they think it is unnecessary, we would base our decisions largely on that.

Senator LODGE. Then, Mr. Warburg, there is a danger here. There are promoters getting up a corporation of perhaps a few thousand dollars, and they issue their bonds and securities, in the normal market where he would have to go, the thing is decided by the intelligence of the investor, but here they can not get the money because it is not considered. How is he going to go about it in trying to get funds?

Mr. WARBURG. We are quite alive to that danger.

Senator LODGE. I think there is great danger there. If they were left to their fate in the market they would not get the money.

Mr. WARBURG. Those are very perplexing questions. We are facing a terrible situation as to maturing obligations. We are having a meeting to-day with the public utility men.

Senator LODGE. The public utility situation is one of the most serious things in the country. They have got millions of dollars coming due, as you are better aware than I am.

Mr. WARBURG. The requirements of these public utilities, I think, are largely renewals.

Senator LODGE. They are renewals, but some of them can not be renewed in the normal market.

Mr. WARBURG. I agree with you. There is one of the things where this war finance corporation will exercise a very important function. This corporation, in many cases, might step in. As I say, those questions are terribly perplexing.

Senator GORE. This War Finance Corporation would provide capital for new corporations, and also new capital required for extensions of old establishments?

Mr. WARBURG. Yes, sir.

Senator GORE. I suppose there would be a great deal of difference in the administration of it, but the control and jurisdiction would be the same?

Mr. WARBURG. Yes, sir; practically the same.

Senator GORE. You could cut out some of these blue-sky activities under this license provision?

Mr. WARBURG. Mr. Blackett told me that nothing that they handled gave them as much trouble as the movies; that is the one thing that bothered them more than anything else. They tried to limit them, and they hurt themselves in doing it. I think we will do well not to touch things unless we have to. But, on the other hand, I can not help saying that the financial problem that is before us is so appalling, the amount of money that has got to be raised is so terrific and comes at such a clip, including what we are providing for our allies, that we are obliged to do one of two things. One is to go on with business and living as usual and finance by inflation; that will bring us to an end very rapidly, and there will be nobody to stand behind us when we reach that point in a similar manner as the United States stood behind England and France. The alternative is to effect savings. That, to my mind, is the only safe road to success, the only sound method with which we can adequately provide funds and provide goods and provide the men.

Senator LODGE. To get that result you want to close down as few industries as possible.

Mr. WARBURG. The ideal solution would be to turn these industries, without a halt, into industries that produce what is required at this time. If you could do that, of course you would have the ideal solution, but you can not do it. You have got to do it gently. The war has caused such a terrific demand for labor, for work that has to be done immediately, that I am not worried at all that, when you close down one factory, that labor is going to have difficulty in finding employment just where it is wanted.

Senator GALLINGER. I was interested in your discussion of the public utilities question, because that is a very important matter, and I think probably would be the most pressing. Let me ask you this question: In a small city of any size, there is one gas company supplying the people, and they have outstanding obligations of perhaps a million dollars about to become due. In that case I assume you would be disposed to think that that obligation ought to be taken care of, would you not?

Mr. WARBURG. Yes, sir.

Senator GALLINGER. And if they asked your approval of security issues to extend that plant you would inquire into the necessity for it?

Mr. WARBURG. I would.

Senator GALLINGER. And deny it if the necessity was not made clear?

Mr. WARBURG. Yes.

Senator GALLINGER. That is about the situation?

Mr. WARBURG. Yes.

The CHAIRMAN. You would grant it if the public welfare required it whether it had any connection with the war or not?

Mr. WARBURG. Yes, sir. And if it was war work we would grant it anyhow.

Senator MCCUMBER. Your prime purpose is to discourage the employment of labor and capital in new industries that are really not necessary.

Mr. WARBURG. Yes.

The CHAIRMAN. The object is to get the money to carry on these things that are essential, and get the money to finance the war.

Mr. WARBURG. Yes. There was one case in point that occurred a few days ago. We had a letter concerning the issue by a municipality of some hundred thousand dollars electric-light bonds, and the question arose whether it was necessary. It was an outlying district, and it seemed that it was not absolutely necessary in that case; but, on the other hand, against it, was the fact that there was a plant almost completed, and to let it stand and let it all go to waste looked to us like a great hardship in view of the small amount involved considering the money already invested; so we decided to let that go through.

And so you could rely, I think, on the fact that whoever would be in charge of this war finance corporation, operating with the Treasury, would be primarily concerned in having the country remain a live body that will be able to pay taxes and produce goods. He would not take any chance of wrecking things. He would be rather inclined to err on the other side.

Senator LODGE. Another phase of the question: You take a concern that is solvent and that is doing a great deal of necessary work, making profit and paying taxes, and it becomes very necessary for them to make extensions in order to do Government work in many such cases. If they are thrown back and obliged to draw on their surplus and cut off all dividends it would at once destroy the concern, cut off its taxation, and its ability to earn money, and so the Government would be deprived of the taxes.

Mr. WARBURG. Oh, no, we are not going to the extent of stopping the payment dividends. We do not force a corporation to stop paying dividends. To do that would bring about disaster. It would

further undermine the security market and would hurt our ability to place loans.

Senator LODGE. It would reduce the income tax also?

Mr. WARBURG. Yes, sir.

Senator LODGE. I did not mean to take up too much time, but there is one other practical instance which I have had in mind in connection with the sugar investigation, in connection with shutting up all candy factories. Candy is not essential to the prosecution of the war, but, as Mr. Hoover said, while it was very desirable to cut down the domestic consumption, it was found not desirable to shut down the manufacture of candy. At first they thought it might be done, but he had gone into that thoroughly and found out how much distress it would cause to shut down.

Senator JONES. They should not be shut down if it could be avoided.

Senator LODGE. He came to the conclusion that it would be better not to shut them down if it could possibly be avoided, and that is not an essential war industry.

Senator GALLINGER. Mr. Warburg, I think the conclusion that we may well reach is that each individual case will be considered by itself?

Mr. WARBURG. Yes.

Senator GALLINGER. And each individual case will have the attention of you gentlemen?

Mr. WARBURG. There is no doubt about that; it will have the close attention of the directors of the corporation.

Senator GALLINGER. That you can not lay down one broad principle to apply without careful investigation of each case. Is that right?

Mr. WARBURG. That is right.

If it is not necessary that it should go into the record, I would like to read you a letter that we wrote to our committee and which contains the principles and rules we have so far adopted.

(Mr. Warburg thereupon read the letter to the committee.)

Senator JONES. The Committee on Indian Affairs has under consideration the advisability of appropriating money for building of new irrigation projects or the extension of projects partially completed.

Senator GALLINGER. I was going to cite not that case, but a similar one.

Senator JONES. It is the policy of the committee not to make any such appropriations.

Senator GALLINGER. I was going to cite irrigation projects as one, and river and harbor appropriations, and sundry other things.

The CHAIRMAN. Mr. Warburg, I notice one or two cases in which a rather vigorous statement was made on the part of certain national banks, and, I believe the National City Bank of New York, against the section which authorizes the Secretary, through the corporation, to issue notes.

Mr. WARBURG. I do not agree with that statement at all. I think it is utterly unwarranted. The writer of it appears to indicate that he considers it the better way to go back into the old method of putting out Aldrich-Vreeland notes rather than securities. Now, this war corporation will issue securities, not notes. That expression "notes" ought to come out.

Senator LODGE. "Notes" should come out entirely?

Mr. WARBURG. It ought to come out entirely. It ought to be "short-term bonds." They must be at least one year long. As far as these bonds go to the public they are not at all going to tend to what you would call inflation, because they would not go into the hands of the members banks or the reserve bank, and no notes, therefore, are issued against them by the Federal reserve bank.

Only when the investment market is filled and when the banks are full, then the banks may come to the Federal reserve banks for relief, and then, along with their commercial paper, they may rediscount some 15-day or 90-day paper, which would be secured by these short-term bonds of the corporation, to the extent and at the rates at which Federal reserve banks may be prepared to discount that paper. Now, to say that that is going to create inflation is true only to that extent as every issue of Government bonds creates, in itself, inflation. Because if the Government instead of the corporation would itself issue these long and short term bonds the effect would be just the same as that produced by the issue of these short-term bonds. Now Liberty loan bonds have no circulation privilege. No more have these short-term bonds. They only can be used as collateral for member banks' notes or paper, which may be rediscounted when the banks get into a condition where they have to take recourse to the Federal reserve banks.

Senator LODGE. Would not that lead to an increase of reserve bank currency?

Mr. WARBURG. Not necessarily.

Senator LODGE. I mean the notes which are issued by the Federal reserve bank.

Mr. WARBURG. I do not think it would mean that always. Let us take this illustration: Suppose a public-utility corporation was trying to renew its maturing notes of $10,000,000; that it could not do so; that it then applied to the War Finance Corporation, through the intermediary of its bank, and secured from that corporation, against the pledge of five-year utility bonds, an equal amount, viz, $10,000,000 of five-year short-term bonds, of the War Finance Corporation. The utility corporation would turn over to its bondholders $1,000 in five-year war-finance bonds for each $1,000 of its maturing obligations. In that case, if every bondholder that owned the public-utility maturing obligation before would take the five-year bond of the corporation, the transaction would have the same effect as if he had received the renewal of his security with the guaranty of the corporation. No additional securities would have been issued. Not a vestige of inflation, neither by credit nor by note issue. It would be simply a substitution of one security that has a market and that would sell for another security which obviously would not. It is thawing up frozen securities.

Senator LODGE. Could you take these bonds to the Federal reserve bank as security and have currency issued on them?

Mr. WARBURG. A bank could. A bank, having made a loan on it, it could. The Finance Corporation could not.

Senator GORE. I wish you would describe how that could be done.

Mr. WARBURG. How that could be done?

Senator GORE. Yes, what the process would be.

Mr. WARBURG. Well, let us take the public utility corporation again, that has received these bonds. They might go to the city bank and say, "I need $250,000. Here is my 90-day note secured by these bonds." The city bank would indorse this $250,000 90-day paper to the Federal Reserve Bank and the Federal Reserve Bank would take it, and it might put it up with the Federal Reserve agent as collateral for notes, and it might not. In the latter case the note issue would not increase in the least through the transaction. Again, the city bank may draw the equivalent by check and may not take out any currency at all.

Senator GORE. It could only be used by the Federal Reserve Bank as collateral?

Mr. WARBURG. Yes, sir.

Senator SMOOT. Let me cite a case to you of what I think is going to happen, after the organization of this corporation with a capital of $500,000,000. There is authorized an issue not to exceed eight times the amount of capital stock of that corporation, which is $4,000,000,000. Then you issue a billion dollars of notes and obligations of this corporation. Now, they go onto the market, and we will say that half of those go into the hands of the investing public and the other half goes into the banks.

Mr. WARBURG. Yes, sir.

Senator SMOOT. Now, when the banks take $500,000,000 of those bonds they no doubt will go to the Federal bank and get currency on that $500,000,000.

Mr. WARBURG. They might not get currency. They might want credit.

Senator SMOOT. Suppose they do get it.

Mr. WARBURG. Yes.

Senator SMOOT. Suppose they do get it; then, when issued, there is that much inflation of the currency.

Mr. WARBURG. Expansion.

Senator SMOOT. Well, what is the difference? It is inflation. Now, I do not see why the Secretary of the Treasury wants to shy at the word "inflation." Everybody knows that we are going to have it. Why not say so?

Mr. WARBURG. We are just now in a terrific process of inflation, worst that the world has ever seen, taking the world as a whole, not the United States, but the world as a whole.

Senator SMOOT. We are coming to it.

Senator LODGE. What is the distinction between inflation of currency and inflation of credit?

Mr. WARBURG. What I mean is this, Senator. No doubt the process that we are going through or that the whole world is going through is one of terrific inflation. That is to-day expressed by the reduced purchasing power of the dollar. The dollar will buy only 50 per cent of what is bought a few years ago. It is not a question of Federal Reserve note issues. It is a question of the rapid manufacturing of credit. It is because all Governments go ahead and issue billions and billions of dollars of bonds for perishable things of no lasting value and create new credits for them and do at at such terrific clip that inflation is produced. The mere fact that you take out $100,000,000 of currency is only a very small factor in the case. We have now outstanding about six billion dollars of Government bonds, which all

could be taken into Federal Reserve Banks to-day in the same manner as the prospective four billion dollars short term bonds of the War Finance Corporation. Of these six billions only $300,000,000 have found their way into the Federal Reserve Banks.

Now, after the issue of the next liberty loan of maybe two, three, or four billions of our liberty loan, or five or six billions—I do not know what it will be—suppose we have $10,000,000,000 outstanding; they are not all going to go into the banks. There have gone into the Federal reserve banks, as I said, only $300,000,000 out of the six billions outstanding now. It stands to reason that with each new issue there will be an increased amount going in, and it must be our object, of course, to keep that down as far as we possibly can. While the Federal Reserve Board and the Federal reserve banks may bend their efforts in this direction, the two decisive factors are the scope and speed of the expenditures of the Government on the one hand and the saving power of the people on the other. Whatever the Government spends in excess of the savings of the people will have to be produced by expansion of bank credit. That can not be entirely avoided, but we have to be careful not to waste our strength too fast. That is why I am so deeply interested in this question of the contraction of unnecessary credit. Credit is just as much a limited thing as any other thing, and we have got to save it, and every individual and every department, State, or municipality, and every corporation has got to save, and unless they do they will have to carry the responsibility for the evil consequences of too rapid inflation.

Senator SMOOT. The Federal Reserve now is limited to the issue of $2,500,000,000. Now, that limit is going to be increased. We are not only going to have inflation to that amount, but we are going to have inflation of billions of dollars in addition.

Mr. WARBURG. Bear in mind that for the time being our note issue power on the gold reserve basis of 40 per cent would permit the issue of additional Federal Reserve notes only of $2,000,000,000, so there is no danger of our ever taking into the Federal reserve banks $4,000,000,000 of war-finance paper.

Senator LODGE. The limit is two and a half bilions. Of that how much has been issued?

Mr. WARBURG. We have about one billion and a quarter outstanding.

Senator LODGE. Then you only have power to issue a billion?

Mr. WARBURG. No; our free gold that we have to-day would enable us to issue on the same basis of 40 per cent another two billion.

Senator LODGE. You are unlimited as to what you should issue?

Senator GORE. How much is outstanding now?

Mr. WARBRG. About $1,250,000,000.

The CHAIRMAN. Suppose you loan on this collateral, as stated, and you find that the banks are getting so much that the situation is hurtful, have you not the means to stop it?

Mr. WARBURG. By all means, we can stop it any day.

The CHAIRMAN. Suppose you had issued a large amount, and you found that there is too much marketed.

Mr. WARBURG. We can stop it at any time by increasing our rate.

Senator JONES. Mr. Warburg, a while ago you used the term "expansion," and if I understood Senator Smoot he rather thought that

that was a distinction without a difference, and I wanted to ask you if there is not a vast and substantial difference between expansion and inflation? In other words, is all expansion properly designated as inflation?

Mr. WARBURG. When expansion becomes extreme and unhealthy, we term it inflation. I should say that as far as the world's general banking and credit situation is concerned and the general price level of things, that we are on an inflated basis. So far as our currency situation is concerned, we are far from inflated. It is about the most conservative that the world has even seen.

Senator LODGE. It is not yet inflated.

Mr. WARBURG. Not yet. That is the point. The Federal reserve banks have still a gold reserve of 65 per cent on notes and deposits, which is more than the Bank of England had in its palmiest days.

Senator LODGE. It is about 30?

Mr. WARBURG. It is less than that. So we are very strong for the time being.

The Federal reserve banks, as the chairman said just now, can control any excess rediscounts of paper secured by war finance bonds. If the thing would get beyond us we can control it by our rates. If we, for instance, see that of this paper we are getting more than we should have, we could put up our rate of interest to 6, 7 or 8 per cent, and the member banks would not give it to us any more. It is obvious, however, that we have to move carefully in exercising this control. In times of peace we could guarantee success. But in times of war, when the Government's finance operations go on continuously, we can not apply too drastic measures, such as might bring the banks of the country into a condition where they might get cramped or embarrassed.

Therefore, in the final analysis, and as stated before, the final result depends upon the expenditures of the Government, on the one hand, and the power of the people and their willingness to save, on the other. In between we can, of course, use our influence to a certain degree, and make it felt within certain limitations, but as long as the war lasts we can put on the brakes only to a degree that will not stop the big wheel of Government from moving as guided by these two factors.

The CHAIRMAN. Now, Mr. Warburg, have you any further facts to state to the committee?

Mr. WARBURG. Only to thank you for your patience.

The CHAIRMAN. Then the committee will adjourn until 10.30 o'clock Monday morning.

(The following memorandum subsequently submitted by Mr. Warburg was ordered incorporated in the record by the chairman, and is here printed in full, as follows:)

WASHINGTON, *February 13, 1918.*

The object of this memorandum is to outline briefly some of the most important points of difference, in substance and effect, between the so-called Calder bill and the War Finance Corporation.

(1) The Calder bill would give power to Federal reserve banks to rediscount member banks' notes secured by "such bonds or notes of any railroad, industrial, public utility corporation or municipality as the Federal Reserve Board upon investigation deems a proper security for the Federal reserve banks to receive as collateral." For the purposes of this memorandum, we must assume,

of course, that if the bill were passed the Federal Reserve Board would permit the rediscount of member-bank notes secured by such collateral. Upon that assumption it is clear that billions of outstanding securities would become directly available as collateral for advances by Federal reserve banks, and indirectly available as security for Federal reserve notes. It would not be a question of dealing only with new financing "compatible with the public interest at this time," or with the renewal of maturing obligations, but the whole mass of securities already outstanding would become available without any power of differentiation at all as to whether or not they are serving the public interest at this time. The proceeds of such borrowing could be used for anything—compatible or incompatible. It is unnecessary to elaborate the importance of this point.

(2) Granting that most of the securities covered by the Calder bill amendment are either unsalable to-day or could be sold only with substantial concessions, even as against the present heavily reduced prices, the Calder bill does not have for its object to find a means of thawing out these frozen securities. The only solution that the Calder bill provides is that holders of securities, either directly or indirectly, pledge them against advances to be secured from Federal reserve banks. The Finance Corporation, on the other hand, provides ways and means by which the appeal should be made not exclusively to the Federal reserve system but to the securities market in general. By substituting, in effect, the short-term bond for the unsalable security of industrial corporations, public utilities, railroads, or municipalities, or by substituting these short-term bonds for the maturing obligations of such corporation, a new security is offered which will have a general market, first, because it will be considered a Government security, and, second, because of the fact that some provision is made, in case of emergency, to use these bonds as collateral for borrowings from Federal reserve banks. To make this point clear: Suppose that an electric company has maturing bonds amounting to $10,000,000; it wants to offer instead a five-year electric note, but finds it impossible to place the same. Under the Calder bill all that could possibly be done would be to borrow the full amount from the Federal reserve bank. Under the plan of the War Finance Corporation, five-year bonds of that corporation would be issued and either taken in exchange by the holders of the old maturing electric notes, or the new five-year short-term bonds could be placed on the market and the proceeds used to pay off the maturing notes. In other words, the Finance Corporation should have the tendency of reopening the security market for now unsalable securities, so that new elasticity will be given the securities market instead of regarding this market as hopelessly dead, and instead of using the Federal reserve system, an instrument created for the protection of commercial paper, as a market upon which to unload unsalable securities.

(3) It is safe to conclude from the above that the amount of paper secured by War Finance Corporation bonds expected to be rediscounted with Federal reserve banks would be much smaller than the amount likely to be borrowed from the Federal Reserve System in the case of the Calder bill, not only because in the first case the absorbing power of the security market acts as a buffer and only what the security market can not take—and what, after that, the banks can not carry—will go into the Federal Reserve System; but also, as stated under (1), because the output of the short-term bonds by the War Finance Corporation is restricted to definite purposes of the present emergency, while under the Calder bill the only possible assistance would have to come through the Federal Reserve System, and all securities issued during past generations would become available as collateral without any scrutiny as to the objects for which they have been issued.

(4) If we have these points clearly in mind, it is incomprehensible why the hue and cry of inflation should be raised against the Finance Corporation by the very people who apparently are in favor of the Calder bill. As a matter of fact, as above stated, we would have to expect a much larger degree of inflation under the Calder bill than under the proposed War Finance Corporation legislation. Are we not driven to the logical conclusion that these critics of the War Finance Corporation bill are opposed to it because it restricts inflation so much more than the Calder bill rather than because they are generally apprehensive of too much inflation to be caused by the contemplated legislation?

PAUL M. WARBURG.

(Whereupon, at 4.50 o'clock p. m., the committee adjourned to meet at 10.30 o'clock a. m. Monday, February 11, 1918.)

ESTABLISHMENT OF A WAR FINANCE CORPORATION.

MONDAY, FEBRUARY 11, 1918.

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to adjournment, at 10.30 o'clock a. m., in the committee room, Capitol, Senator F. M. Simmons presiding.

Present, Senators Simmons (chairman), Stone, Williams, Thomas, Gerry, Lodge, McCumber, Smoot, Gallinger, and Townsend.

Present also, Hon. William G. McAdoo, Secretary of the Treasury.

The CHAIRMAN. Mr. Secretary, I presume you desire to make some statement to the committee, in addition to your written statement, with oral interpellations which you made on Friday.

Secretary MCADOO. I have nothing in particular to add, Senator. I should be very glad to respond to any questions that may be asked. I understood that some members of the committee desired to ask some questions.

STATEMENT OF HON. WILLIAM G. McADOO, SECRETARY OF THE TREASURY.

The CHAIRMAN. I think Senator Lodge indicated a desire to ask some questions of you.

Senator LODGE. I wanted to ask a little about the licensing feature; that is, the power of approving or disapproving issues of bonds for new capital, or other evidences of indebtedness; why it was necessary to go beyond what we are doing now voluntarily, and what has been done by the English committee voluntarily and which seems to be extremely effective. It has been very effective in England, certainly.

Secretary MCADOO. The English committee has back of it the power of compulsion which it can assert if it needs to, and my feeling is that we should have similar power here.

Senator LODGE. The English have no such law.

Secretary MCADOO. That is, I understand from what some of the representatives of the British Government have said to me that they can assert the power without the enactment of a special law for the purpose. They have other powers through which they could exercise compulsion if it were necessary, and my feeling is that we ought to possess a similar power here, not that we would have to exercise it, but in order that it could be exercised if it turned out to be necessary. For that reason the bill is so drawn that the corporation merely has the power to issue regulations for licensing. I should prefer very much to let the Federal Reserve Committee, which is doing excellent work at the moment, continue to exercise that function, and I should

hope that every one would submit their proposed capital expenditures——

Senator SMITH. What is the Federal Reserve Committee?

Secretary MCADOO. Yes. It is a committee organized at my request to pass on new capital issues or expenditures.

Senator LODGE. We had a very interesting account from Mr. Warburg, who was here the other day as the head of that committee, when you were not here.

Senator SMITH. I had an engagement with the Secretary of War, and I was obliged to leave.

Senator SMOOT. You do not believe any considerable issue of new capital or any new indebtedness of any other description should be created as against an adverse report made by a voluntary committee?

Secretary MCADOO. No; I do not. But suppose they do not submit the proposed security issue to the committee at all.

Senator SMOOT. Then the committee could take action. And if the money market should be in such shape that investors are not hunting for such investments, the banks will not be hunting for them, and I think they will not undertake to finance them unless they are O. K.'d by the committee; and before they can be sold, in my opinion, they will have to be O. K.'d by that voluntary committee, and therefore I think that it is unwise to place a penalty such as the bill provides upon a man who undertook to, say, secure $200,000 without permission. He may get it, of course, from a friend, and would not interfere with any business he may invest it in, so it seems to me that the English system is all that is sufficient; and the figures show that it has virtually stopped all unnecessary expansion of business and also taken care of it in a most excellent way.

Secretary MCADOO. We have a very large country, and these financial operations cover a great deal of ground, and many financial transactions are not the result of public offerings of securities. There are many transactions involving capital issues that ought to be passed upon at this time that are between the banks, for instance, and the concerns direct; I mean those in excess of $100,000. The problem we must consider is this: The demands of the Government for the necessary funds to carry on this war are so great and are going to be so much greater as the war proceeds that we owe it as a primary duty to the country to arm ourselves with the power to restrict or to restrain as much as possible the use of capital in directions which will not be helpful in the conduct of the war. The point is simply to have the power reside somewhere so that it may be exercised if it must be exercised. Now, the purpose is not to use that power arbitrarily or destructively; it is not so much to use the power to prevent things as it is to give a preference to things. Where new capital issues are proposed they should be considered in relation to the general problem, and those things which are obviously the things that must first be taken care of for the purposes of the war should have preference.

Senator THOMAS. Let me ask a question there, and I must precede it with a statement by way of explanation. The controversy between the city of Denver and the Denver City Water Works, which began in 1906, is about to culminate with a final decision of the Supreme Court. The appeal is from an award, I think, of $14,000,000

as the value of the plant of the water company. An agreement made subsequent to this award between the city and the company provides that if the case is affirmed the city shall have the right to purchase within a short time after the announcement of the decision the plant of the company for the amount of the award. Now, we assume that if the Supreme Court affirms that judgment, then the city must provide a bond issue in order to comply with this option to take the property—and it wants to do it—at a price somewhere in the neighborhood of $15,000,000. Will it be possible under this bill, if enacted into law, to finance such a bond issue? It does not affect the war, perhaps even indirectly, but it is a matter of tremendous importance to that particular community, which has expended perhaps $500,000 in the cost of this litigation.

Secretary McADOO. I think, Senator, that is obviously a case where the city would be permitted to issue securities, because that is a contract or arrangement which was made before this bill was introduced. Then, again, I think that all those expenditures which relate to the life and health of communities are of essential importance to the conduct of the war.

Senator THOMAS. The transfer of this company will not affect the sanitary conditions in that city, but will substitute municipal for private ownership.

Secretary McADOO. I was dealing with two phases of it, the first of which is that wherever contracts have been made or proceedings have been begun involving obligations or options or contracts of this character I think we should not interfere, and there would be no purpose to interfere.

Senator TOWNSEND. You could do it under the bill?

Secretary McADOO. No; I do not think so, because a municipality can issue bonds regardless of this bill. We can not control that.

Senator TOWNSEND. They can not sell them?

Secretary McADOO. I do not think they could sell them now through bankers, but a city could nevertheless offer for public subscription and sell their securities, whether this capital issues committee thought well of or not.

Senator THOMAS. I am satisfied that if we enact this measure into law it will be very difficult to market securities which do not have the express approval of the corporation we are about to create.

Secretary McADOO. That is going to be difficult, Senator. The point is not so much to put a restraining power upon those sort of public offers as it is to put a restraining influence upon unnecessary capital issues or expenditures by private enterprises.

Senator TOWNSEND. One of your objects is to restrain the expenditures of money by municipalities?

Senator LODGE. There is no other place where that is so much needed.

Secretary McADOO. Of course it is; but what I mean to say is this: It is the moral restraint that has to affect the municipalities; we can not control them absolutely, no matter what you do.

Senator SMOOT. England has controlled them; in fact, they are nearly wiped out.

Secretary McADOO. But England is a very different proposition from America. There the Parliament enacts the law of the realm,

and you can approach the matter from an entirely different standpoint. Here we can not control the different sovereignties which compose our union in respect of matters not delegated to the Federal Union.

Senator McCUMBER. Do you contend that Congress has the power to enact a law which would prevent a State from exercising its own sovereign power of issuing State bonds and selling those State bonds without a license from the Government?

Secretary McADOO. No; I say we have not that power.

Senator LODGE. How about the sale of bonds by a municipality?

Secretary McADOO. We can not prevent that.

Senator McCUMBER. Certainly, if you have not the power over a State you would not have it over a municipality.

Senator THOMAS. It is the moral effect of that adverse report.

Senator SMITH. We have just passed a moratorium as to State courts, and I do not see why we could not control the issue of bonds, too.

Senator McCUMBER. If we should pass a law compelling every corporation or individual who desires to sell bonds over $100,000 to first obtain a license and provide a penalty if an attempt is made without first obtaining a license, is there not danger that the delays, the investigations, the doubts, and uncertainties that will be cast over the entire business world would be more damaging in the matter of raising revenues than could be offset by any benefits under this law?

Secretary McADOO. I do not think so, Senator; I emphatically do not believe so.

Senator McCUMBER. I confess I am a little afraid of it.

Secretary McADOO. What is the supreme need of the Nation to-day? It is to marshal its financial resources in such way that the Government may be able to command absolutely the money necessary to carry on the war. Now, the rights of a municipality or of a State, or of an individual must be subordinated to the supreme need of the Nation. I think the danger to municipalities and to the States is infinitely greater if we do not regulate this matter intelligently than if we defer merely to the idea that a State or municipality should be permitted to go ahead regardless of the national interest.

Senator McCUMBER. After all, you have got to get the money from the people. The people have got to get their money from business. Therefore we must not have any kind of scheme which will hamper or jeopardize the business of the country, which, after all, must furnish the funds either to buy the Government bonds or to respond in taxation for Government needs.

Secretary McADOO. I do not think anyone is more concerned in conserving prosperity and in preserving the equilibrium of the business of the country than the Treasury Department, and every effort that the Treasury Department has made has been in the direction of such preservation.

Our idea is that we are going to help business by this form of regulation, a regulation applying to everybody alike, all business alike, so that people will know where they can have these questions settled. As it stands to-day, and particularly before we organized this voluntary committee of the Federal Reserve Board, people did not know

what to do. This voluntary organization has sprung out of the demand of business enterprise itself for the determination of these questions. They want a determination and it is essential that they should have it. This bill merely gives the corporation the power to license, and as I said in my statement the other day it is intended that the corporation shall use the machinery of the Federal reserve capital issue committee already established. It is possible to use that machinery and I hope that it will result in that organization not being interfered with. I believe the mere existence of the power to force this licensing would make it unnecessary to exercise it.

Senator TOWNSEND. You think that Congress does not have the power to legally interfere with the sale of bonds issued by State authorities or municipal authorities?

Secretary MCADOO. Not to prohibit them. I say, Senator.

Senator TOWNSEND. To what would your penalty apply? Where would you apply the penalty for violation of the provisions of the bill?

Secretary MCADOO. It would apply to the banker who undertook to sell those bonds without a license; he would be subject to a penalty.

Senator TOWNSEND. A national banker?

Secretary MCADOO. Any banker, private or national.

Senator TOWNSEND. Or broker?

Secretary MCADOO. Or individual. In other words, if the municipality resorted to a banker for the sale of the bonds, that banker could not sell the bonds unless he was licensed.

Senator TOWNSEND. Anybody who undertook to float the issue of bonds would be subject to the penalty.

Secretary MCADOO. He would be subject to the penalty.

Senator SMITH. You think Congress has the authority to provide for a licensing system as to all sellers of bonds?

Secretary MCADOO. That is my theory.

Senator TOWNSEND. What I can not distinguish is the difference between the State banker or State agent and the corporation; you say you could not prevent the corporation from selling the bonds.

Secretary MCADOO. You mean municipal corporations? They could offer them direct to the public. A State could advertise those bonds.

Senator TOWNSEND. But it could not have any agent?

Secretary MCADOO. It could not use a bank or a banker unless that bank or banker was licensed.

Senator SMOOT. It could not use anybody that had the money to buy the obligations.

Senator TOWNSEND. The distinction does not seem to be good.

Secretary MCADOO. Suppose your city wanted to sell municipal securities, for instance, for a new courthouse, when you could get along without it until peace returned. Suppose you offered those securities to bankers, and those bankers said to the Federal reserve committee, this voluntary organization, "Do you think this is the kind of issue we ought to sell?" and the Federal reserve committee said, "No; you should not offer them," then the bankers would not offer them. If, on the other hand, the city said, "All right, we are going ahead anyway, and we will offer our bonds to our own people for

subscription; we will invite subscription direct," they could do it; and if the people subscribed, of course the city would have the money and could go ahead.

Senator TOWNSEND. Let us take a step further in the banking proposition, because I am in sympathy with any proposition here that will accomplish without favoritism a square, equitable deal; suppose the municipality goes to the bank and says: "We want you to take some of these bonds." You say the bank would have to get advice from the Federal Reserve Corporation?

Secretary MCADOO. I did not say it would have to; I say it would be supposed to do so.

Senator TOWNSEND. If it took them without, it would be subject to the penalty?

Secretary MCADOO. No. Mr. Franklin, the bill would not apply to a purchase by a bank in such circumstances, but they could not sell them?

Mr. FRANKLIN. The bank could subscribe to the municipalities' securities.

Senator JONES. The act says no person, firm, corporation, or association shall sell or offer for sale or subscription any issue or any part of any issue of securities hereafter issued if the face value of it shall be in excess of $100,000, except in accordance with the regulations, etc. That on its face would include municipal corporations, would it not?

Secretary MCADOO. No. It is not intended to, because municipal corporations do not act as agencies for the sale of securities. But let me say that anyone may buy these securities. It does not inhibit the purchase of securities by people. It is only intended to license the agencies through which offerings are made to the public. If the banks wanted to buy these securities from municipalities, they could do so.

Senator TOWNSEND. Suppose they did not apply for a license? They would be subject to the penalty?

Secretary MCADOO. No, sir.

Senator TOWNSEND. Suppose a State bank takes the issue of bonds offered by a municipality in this State and the State bank does offer to sell those bonds. Is that bank subject to the penalty.

Secretary MCADOO. It would be if this bill passed.

Senator SMOOT. They could not get any kind of credit at the Federal Reserve Board.

Senator TOWNSEND. I realize how it would have the effect upon the banking institutions to force them into applying for a license, but I can not well see how we could pass a law that would penalize a State bank for selling a State issue of bonds in the State authorized under the laws of the State.

Secretary MCADOO. That is a legal question, Senator. If the Federal Government has no power to control the State banks in such circumstances, then, of course, we can not exercise it. My point is this: I think it is essential that such power reside somewhere. It may not be necessary to resort to it. The mere existence of the power would probably make it unnecessary to apply the compulsion. But I say as a result of my experience with what the Government has had to finance and will have to finance that unless we can control, either by voluntary action or by a sufficient measure of com-

pulsion, the use of new capital in this country, so that it shall not be employed in utterly unnecessary things, our difficulties in financing this war are going to constantly increase. They are going to increase anyway, but they are going to multiply in a much greater ratio.

Senator TOWNSEND. I still feel, from reading this statement and from your statement and that of Mr. Warburg, that this thing can only be accomplished through the voluntary act of these people, and they are going to do it. Have you any cases, has the board come up with any case, where a firm or corporation has refused to submit a proposition to the voluntary board?

Secretary MCADOO. We can not answer that, Senator, because we do not know what they are offering all over the country.

Senator TOWNSEND. Have you any cases where that has occurred?

Secretary MCADOO. Mr. Warburg, have you had any such cases?

Mr. WARBURG. I do not believe we can really tell, because we have just begun to operate; but no doubt a great many securities have been sold without our O. K.

Senator SMOOT. The business interests of the country hardly know this organization is in existence.

Mr. WARBURG. No.

Secretary MCADOO. Unless there is some way of compelling the submission of these questions we can not tell what offerings are made or what transactions have taken place.

Senator JONES. I recall having seen an advertisement within the last day or two that some mining company wanted to sell $250,000 worth of stock through advertising in the papers and by circulars, and I apprehend that that has never been brought to the attention of this voluntary organization.

Secretary MCADOO. That will simply continue unless there is some power to regulate or control it.

Senator SMITH. Your regulations are only to apply to those who are required to take out licenses?

Secretary MCADOO. Certainly.

Senator SMITH. And you require to take out licenses those who engage in the business of selling bonds issued by others.

Secretary MCADOO. Yes.

Senator SMITH. Do you go further than that?

Secretary MCADOO. Yes; it applies also to the offering by individuals or corporations.

Senator SMITH. Of their own bonds?

Secretary MCADOO. Not States or municipalities, however, because my own belief is that the Congress has no power to prevent a State or municipality from selling directly its obligations.

Senator LODGE. If the committee, whether voluntary or with the law behind it, should disapprove a municipal loan, it would never get anywhere, and I think the municipalities are one of the worst places for unnecessary expenditures.

Secretary MCADOO. The point is this, Senator. A municipality might offer its securities regardless of this committee direct to the public without seeking to have a bank sell them.

Senator LODGE. They would not get far if it were known they were disapproved.

Secretary McADOO. I hope that is true; we would like to have that restraint upon them.

Senator SMOOT. They would not sell 5 per cent of them.

Secretary McADOO. The point I should like to emphasize is this, gentlemen: I am satisfied that no injustice can be done through the possession of this power by some responsible agency authorized by the Government to exercise it. The mere existence of such power will, in my judgment, make it unnecessary to exercise it. I think the voluntary action now set in motion will be perfected by the passage of this act; but if conditions do develop where the compulsion should be exercised, we should have the power to exercise that compulsion.

Senator WILLIAMS. There might be a few people who would try to do it.

Senator SMOOT. I think that is where the danger lies. I think this license section gives the power to virtually bankrupt any business in the United States that borrowed that large sum of money. I do not say they will do it, but the power is there, and I have not any doubt in my mind but that the voluntary system would take care of every case in the United States.

Secretary McADOO. Would not the voluntary system bankrupt them just the same?

Senator SMOOT. No; they would at least have this chance, that they would not be penalized if they undertook it. They would under this law. I do not think that the voluntary system would have the same effect as the compulsory system provided here, and, as I was saying, I doubt very much whether any new issue could be issued with this board's disapproval; but the refunding of an old issue, if the board had recommended against it, would not be possible, whereas under the voluntary system they would have a chance to make arrangements with the people who are carrying it to-day, and I do not think they ought to be penalized for that. I think the power asked for is altogether too great.

Secretary McADOO. In the first place, as to refunding operations, clearly there would be no interference with refunding operations unless the corporation had a sinking fund or sufficient resources in hand to make it unnecessary to refund their obligations.

Senator SMOOT. But suppose they have not.

Secretary McADOO. Then there would be no difficulty about it, because the purpose is not to destroy, but to help; the purpose is to facilitate. Let me emphasize and stress this point: The purpose is to facilitate, through the proper regulation of credit, the readjustments that are inevitable during this war in many industries of this country and to assist those processes of readjustment which are already under way and are going forward in a somewhat chaotic fashion at the present time. For instance, there may be industries which are not directly contributory to the war which are going to be very seriously affected by the war. I think that such industries could, with probably a small or a reasonable amount of assistance, be converted into something that would be very useful for the purposes of the war. They have skilled artisans, and their machinery and their facilities might be adapted to war purposes if they were assisted. As things stand to-day it is difficult for them to get the credit to facilitate such a process of adjustment, and the purpose

of this corporation in all such cases is to assist that process as well as the exercise of reasonable discrimination between the things which will not be useful or helpful to the war and those which will. Pre-existing contracts, maturing obligations, and things of that kind, if the corporation has no means of meeting them, whether such obligations are compatible with the war-making function or not, would have to be respected, because we can not afford to impair the right of those people to protect themselves, and in such cases the action of this corporation would be beneficial because it would help them finance their requirements.

So far as the dangers to which you refer are concerned, I think we have got to weigh those dangers. I do not apprehend the dangers you do, but if they are present in the situation we have got to weigh one danger against another, and we have got to determine whether we are subjecting the national interest to a graver danger by not doing this thing than in doing it.

Senator SMOOT. We all agree to that, but I can not see that we are. Whether it is voluntary or whether it is compulsory, the conditions as they exist to-day as you state them will be changed if this legislation is passed. There is not any doubt that some sort of legislation of this kind has got to be adopted, because without it we can not finance the business of this country and finance this war at the same time. But I do believe that no power should be granted here to any living man to say right off that if there is a business here I want to destroy I can destroy it.

Secretary MCADOO. You misconceive entirely the purpose of the bill. The purpose of the bill is not to determine whether somebody should be destroyed, but who shall be helped most.

Senator SMOOT. But that is the question. I know that is not the purpose of the bill, but why put the power to do it into the bill? It is a power, and there is no necessity of it, in my opinion, and there has not been in England. There has been no forcing there; there is not a penalty attached there, and it has worked admirably in England. It will here with the voluntary system, and, as far as I am concerned, that is what I would like to see; I think everything will be accomplished by the voluntary plan.

Secretary MCADOO. It is, at least, speculative. This is no time for speculative measures, if I may be allowed to say so. You have got to have the power to oblige people to do their share with respect to the conservation of the capital of the country, and if you want to take chances on it and something goes wrong you may find you can not correct it. Now, the mere existence of this power is, in my judgment, going to solve the problem. I do not believe it will be necessary to issue a regulation if the power to issue it exists. If you do not provide the authority, and especially if, after the matter has been discussed in Congress, Congress should deliberately say, "We will rely upon the voluntary system for restraining the unwise use of capital. We refused to rely on the voluntary system for an Army, so we drafted men and sent them out to die, but we will be more fair to capital. We will let capital volunteer, and if it does not we will give capital the chance to wreck the armies in the field." I say that between doing that and giving the power to protect our armies and the national interests, we ought to give the power.

Senator SMOOT. Let me ask you a question and see how you feel in relation to the matter. Suppose there was a company—I do not care where it may be located—claiming that they would issue a million dollars of bonds or $10,000,000. Under the bill they would have to have a license to do so. Now, their request came to this board that may be created under the bill, and the board turned it down and said that it was not necessary at this time to begin that business. It would not help the war; it would not help the country. There were not funds sufficient to finance such institutions. Everyone in the United States would be notified of that. Do you think, Mr. Secretary, that it would be possible to sell those bonds in the United States?

Secretary MCADOO. Suppose that under this voluntary system they do not submit the case to the committee. Suppose that banks bought their securities and sold them without ever having asked the judgment of the committee. They could do that. The point is that if we could always be sure that every concern would voluntarily submit its proposed capital expenditures to the committee this legislation would not be required. If you do not provide for that compulsion many concerns will undoubtedly seek to finance themselves through local influences or agencies without ever having asked the judgment of this committee.

Senator SMOOT. You know that every bank in the United States is already to-day right up to the limit of financing money for carrying on the present business of the country.

Secretary MCADOO. No; I do not know that. On the contrary, I think they are not.

Senator SMOOT. I think they are. Not only that, but they are not going to buy any securities that they can not use as credit with the Federal Reserve Board. They are not going to buy under those circumstances. There will be plenty of securities that can be used when this bill passes, and they are going to take them and are not going outside. They are not going to have their money tied up with securities they can not handle, that are dead, and all they can get out of them is simply the interest on the bonds. They can not sell them; it will be impossible to do that in this country or any other.

Secretary MCADOO. That is merely assumption. You have no right to assume that people are going to do any such thing, if I may be allowed to say so, because everybody does not do the right thing. That is exactly the same argument that was used when the draft law was proposed. They said, "Let us stick to the volunteer system; we will raise an army; we will have millions of men who will volunteer to go." But you can not fight a great war that way, and we had to enact the selective-draft law to take men to fight the battles. If we are not going to compel people back of the lines to use capital to support the men who have been drafted and sent to the front to die, if necessary, I do not think we shall be doing the right thing.

Senator SMOOT. But I can not see any comparison between the two at all. In this bill you have absolute power to say that they can not use that money for certain purposes even though they undertake to do it.

Secretary MCADOO. That is not as great a power as saying, "You go out and die for your country."

Senator SMOOT. That is quite a different thing—an exchange of dollars.

Secretary McADOO. If you want to take chances you will not pass this bill. If you want to conserve capital for the uses of this Government at the time when it is going to be needed in increased amounts you must pass it. From what I have experienced in the Treasury Department, this power ought to be conferred. I am frank to say that I have come to this conclusion with reluctance; that I would prefer not to exercise this power. It is a new and an additional load, but it is essential that it be carried. I can only state, with all the emphasis I can command, that it is an essential thing to do, and I think that the best banking brains in the country are of the same opinion. At least, some of the best banking brains I have consulted were of the opinion and have urged it very strongly.

When it was first suggested to me my judgment was opposed to it. I have become convinced of it as we have gone along.

Senator LODGE. Mr. Secretary, it seems to me if you conscript capital you confiscate it, of course, just as you take the man. The object here, it seems to me, is rather different.

Secretary McADOO. It is not conscripting capital.

Senator LODGE. But you will have to conscript capital if you are going to put it on the level with the man. If you treat capital as you treat men, you simply take the money away when you want it. But, as I understand it, the object is to get our loans taken and our taxes paid, and we do not want money unnecessarily diverted from those objects. That is the real object of the bill.

Secretary McADOO. Precisely.

Senator LODGE. It is not a question of seizing capital. It is a question of making it as productive for Government purposes as possible.

Secretary McADOO. Yes, sir; and merely regulating it for that purpose.

Senator WILLIAMS. Regulating it by preferential designation.

Senator LODGE. That being the case, you have, in the first place, the power of absolutely forbidding any assistance to a financial corporation in the issue of new bonds or to call for new money which does not meet the approval of the board. That would seem to me to be a power that would settle the whole thing. But it seems to me we are overlooking one thing, which is perhaps a question of administration, but which, it seems to me, is very important. I do not apprehend so much danger from the destruction of business, because I am certain that that is not the desire of the corporation or of the Treasury as from dubious enterprises, which would not live a minute in the market if they tried to get money in the market, because the market would not have anything to do with them. They will come down here—some of them are here now—with very plausible cases, stating that they are going to assist the Government, and they are doing Government work or something of that sort, and I think there is a great danger in that direction. I think there are a great many things which would better be left to the mercies of the market, which is a pretty hard one just at present. I think there are a great many cases that would be taken care of under the voluntary system instead of having them come here and have an opportunity to make a very plausible case to the effect that their work is going to be of value to the Government. I think there is a great danger in that direction.

The CHAIRMAN. Do not they have that under the voluntary system?

Senator LODGE. Absolutely; I realize that.

Secretary MCADOO. We have a committee now operating for the Federal Reserve Board, of which Mr. Warburg is chairman—I appointed this committee—it is composed of men of fine intelligence and capacity, and I doubt very much if any plausible scheme would get through unless it had a very good foundation.

Senator LODGE. I have very great confidence in that committee of the Federal Reserve Board, but I have in mind some cases where companies have been formed to take Government work and they had no money and could not get money from the market on their own merits, and they came down here and under the law they got a third of their contract to start on, which makes an immediate and bad drain on the Treasury, which you spoke of the other day, and those are the things which I fear quite as much as anything else. That is why I think it is so important to leave it in the hands of the Federal Reserve Board, which has the work in hand already and know it and are not amateurs, and they know how to judge of those things.

Secretary MCADOO. That committee, Senator, was organized at the very time we had this bill in contemplation for the express purpose of giving it an official status when this bill is passed, if it is passed. I am creating that organization for the very purpose of administering this phase of the bill if it should pass. The whole value of this provision of the bill is simply to enable us to give that committee that power, and it is necessary that it should have the power.

Senator LODGE. Under this bill an entirely new body of people are going to pass on these issues of new capital?

Secretary MCADOO. Not at all.

Senator LODGE. It is put into the hands of the directors of the corporation.

Secretary MCADOO. You have got to establish the agency through which that power will be exercised, and this Federal reserve committee is to become the official representative of this corporation in performing that function.

Senator LODGE. Would it be objectionable to have that question that you sum up in the word "license," that power to license new issues, left by law in the hands of the Federal Reserve Board?

Secretary MCADOO. I should not object to that, except for this reason: This power should be exercised in thorough cooperation and harmony with the policies of this corporation. If you make another body independent of it, that body might license issues that the corporation might find very objectionable, and therefore I think that for good administration and for the carrying forward of a perfectly definite policy it ought to be exercised by one authority.

Senator MCCUMBER. If the authority was in the board but the administration was through the heads of the Federal banking system, would not that accomplish it?

Secretary MCADOO. That is exactly what this is designed to do.

Senator MCCUMBER. What objection would there be to so declaring in the law itself, that that should be the administrative branch of that power?

Senator LODGE. That no license should be given by the finance corporation unless the enterprise had the approval of the Federal Reserve Board?

Secretary MCADOO. You have got to have two independent bodies agreeing on things, and they might disagree.

Senator WILLIAMS. You might have to appoint a conference committee.

Secretary MCADOO. Yes; I imagine that there will never be any difficulties between the Federal Reserve Board and the Treasury, as the Secretary of the Treasury is the chairman of the Federal Reserve Board. We have been working together for the past four years, and the agencies of the Federal Reserve Board are immensely helpful in doing this work. While I should not object if Congress wants to make that division of power, I think it is unwise because the policies ought to be controlled and made to reciprocate thoroughly. If you make a division of power of that sort you never know when some difference of opinion may arise out of its independent exercise. That is all. It is necessary that the corporation's operations shall be made thoroughly reciprocal with the policies of the Treasury Department. You could not run this corporation independently of the Treasury. It would be a great mistake. We might have a bad mix-up sometime.

Senator LODGE. You would be obliged, of course, to have some agency to pass upon these proposed new loans.

Secretary MCADOO. Certainly, and that is the reason, Senator.

Senator LODGE. If you have an agency, what better one could you find than the one now operating?

Secretary MCADOO. We can not; and I say that was the purpose of this bill, and it will be my purpose as a member of the Board of Directors to vote to have the Federal Reserve Committee, which is already organized, continue to exercise these powers; but the corporation would then have the power to control the general policy.

Senator LODGE. They would have the power to say what should be issued?

Senator TOWNSEND. What would be the objection to having the Federal Reserve Board, of which you are the president or chairman now, authorized to do the things you speak of in this bill, without any reference to a corporation?

Secretary MCADOO. You mean the licensing power?

Senator TOWNSEND. Yes.

Secretary MCADOO. No objection, except you have two independent functions, and if any difference of opinion should arise it might cause trouble.

Senator TOWNSEND. I do not want different functions. I do not want any division.

Senator THOMAS. If we cover everything in the bill.

Secretary MCADOO. You mean the whole function?

Senator THOMAS. Yes.

Secretary MCADOO. That is manifestly impossible. You have got to have a corporation that issues bonds and has capital.

Senator THOMAS. Are not the members of the Federal Reserve Board ipso facto members of that corporation?

Secretary McADOO. The bill is drawn so that you can have members of the Federal Reserve Board as members of the corporation.

Senator McCUMBER. You can make them the corporation if you wish to?

Senator THOMAS. I hate the further division of authority.

Secretary McADOO. You could put them on as directors, and this bill says you may use anybody connected with the Government now as members of the board of directors of this corporation.

Senator TOWNSEND. Suppose we say a corporation consisting of the Secretary of the Treasury and this voluntary committee you have now, naming them, shall constitute the directors of this corporation?

Senator SMOOT. The chairman of the Federal Reserve Board shall be the chairman of the corporation. As I understand, the Senator from Michigan wants the bill itself to provide that the board of the corporation shall consist of the same members as the Federal Reserve Board.

Secretary McADOO. You want to make the personnel of the Federal Reserve Board the same as this corporation?

Senator TOWNSEND. I want to legalize the work you are doing now.

Secretary McADOO. Are you speaking of the licenses or of the entire function?

Senator TOWNSEND. The entire function; no division.

Secretary McADOO. One reason why in the composition of this board it is proposed that the Secretary of the Treasury shall nominate the directors, with the President's approval, is to be certain that we shall have an organization which will reciprocate thoroughly with the Treasury and its policies. If you were to confer these powers on an independent board in which the Secretary of the Treasury would merely have a vote, that board could do things inconsistent with the policies of the Treasury, which are dictated by the Secretary of the Treasury, and a very unfortunate situation might be produced. We must be sure that the operations of this corporation are in complete harmony with the policies of the Treasury.

Senator SMOOT. You have just made the statement that you have no fear whatever that the Federal board would not be in harmony with the Secretary of the Treasury or the Treasury Department, and therefore if they make the Federal Reserve Board the members of this corporation I do not see how it could be out of harmony with the Treasury Department.

Secretary McADOO. If you, by legislation, create the personnel of the board, which is not usual, and you make it entirely independent of the Treasury, you could not tell whether that board would function with the Treasury or not.

Senator WILLIAMS. While there might be the utmost harmony now, disharmony might arise?

Secretary McADOO. I should not expect it, but I think the principle would be bad of creating a corporation in that fashion.

Senator SMOOT. There might be a matter of harmony as to who was appointed.

Secretary McADOO. There would not be anything like the chance of disharmony as the bill is drawn that there would be otherwise.

Senator McCUMBER. What you want is the veto power?

Secretary McADOO. I think it is essential that the Secretary of the Treasury shall have that veto power. That is clearly intended in this bill. These policies must harmonize with the Treasury policies, if the financing of the Government is to be carried forward upon a definite and consistent idea.

Senator GALLINGER. I have about 20 questions to propound to the Secretary, but I think we understand his attitude, and I believe other gentlemen are to be heard. Might we not move along?

The CHAIRMAN. I think every member of the committee ought to have an opportunity to ask the questions he may desire, because this is a very important question that we are considering now. It is vital to the bill, as I look at it.

Secretary McADOO. The fundamental principle of this bill is to create an additional agency to assist the Treasury of the United States to raise money in carrying on this war. It is vital that the policies be those of the United States Treasury, and we must not take any chance of having those policies conflict, because if a power is constituted which might eventuate in differences of opinion about policy it might seriously affect the financial plans of the Government. You have got to protect the Secretary of the Treasury against taking these chances of difference of opinion about policies. Boards, as a rule, debate a great deal. I, myself, with the highest appreciation of the value of boards of directors and other boards, do not look upon them in great emergencies as having the power to function quickly enough. The Secretary of the Treasury has enormous emergency powers already which are exercised instantly. Frequently he does not have time to debate propositions that come before the department. He must act quickly.

Some one must have the responsibility, and some one must act in such cases. Unless this bill is passed in such for that the policies of this corporation coincide with Treasury policies, it will not meet the situation.

Senator TOWNSEND. You provide in this bill for a board of four additional persons. Do you mean to say you do not have to consult with those four?

Secretary McADOO. No, sir; I did not mean to say that.

Senator TOWNSEND. The Secretary of the Treasury is not supreme in that case, then. He has a board, but you suggest that you appoint them, I suppose with the idea that they would do as you requested them to do. Just what is the use of a board of that kind? Why not make a corporation consisting entirely of the Secretary of the Treasury?

Secretary McADOO. Because a board of directors is one of the essential elements of a corporation, and we must have a corporation to do this job. I said very frankly in my statement the other day, that if these powers could be exercised by the Secretary of the Treasury with his Assistant Secretaries, as he exercises all the other vast powers of the Treasury Department it would be better. I should feel more contented if that could be done, but it is not practicable. I should be more contented with that arrangement merely because it would be more certain that there would be no difference between the policies of the corporation and those of the Treasury

Department. But if the board of directors should be chosen by the Secretary of the Treasury, with the approval of the President, I believe that we should get men who would cooperate with the Secretary of the Treasury in this work just as thoroughly as the Assistant Secretaries of the Treasury cooperate with the Secretary.

Senator TOWNSEND. It may be necessary to give one man this power. It is an emergency power. I recognize that, but it does not seem to me to be of that nature that would require unrestricted authority to be given to some man who might, exercising the best of judgment, destroy conditions in this country which are absolutely essential to the carrying on of the war; and I had the thought that the Federal Reserve Board was so closely identified with the Treasury, its appointments being dictated by the Treasury Department, and because we know the men, we know what they are doing, the country would have confidence in them, and that board might be empowered to do what you want done here, and at the same time there would be an assurance to the country that to me seems almost essential at this time.

Senator LODGE. My only suggestion was that the Federal Reserve Board should have the power to pass on the licenses issued, which is not a part of the policy but is dealing with each separate case as it comes up. It does not seem to me it is a question of Treasury policy to say that A shall have a license and B shall not.

Secretary MCADOO. In answer to Senator Lodge, let me say that the Federal Reserve Board has a very distinctive function to perform for the country. It has a great deal to do. I do not believe this board has the time. This is going to be a very large additional operation, and, as far as the Secretary of the Treasury is concerned, he can only supervise and control general policies, and can not administer every detail of these organizations. The board has a very distinct function to perform, and I do not think it really could take on this duty.

Senator LODGE. They are performing it now.

Secretary MCADOO. I am speaking of the corporation itself.

Senator LODGE. I did not mean that. I only limited it to what they are doing now.

Secretary MCADOO. There is no objection to that.

Senator TOWNSEND. Your banking system and this system are very distinctly related. This is to be an aid to the currency system in obtaining money.

Secretary MCADOO. The Federal Reserve Board is related to the whole operation—has the control of the issue of any currency that can be issued by the Federal reserve banks.

The licensing feature is rather a distinctive feature of the bill. That power could be conferred independently more readily than any other power in the bill, and I should have no objection to conferring that power upon the Federal Reserve Board.

Senator WILLIAMS. The mere power to license?

Secretary MCADOO. Yes, sir.

Senator LODGE. There has got to be an agency for that.

Secretary MCADOO. I had intended to use this voluntary organization. There are on the committee three members of the Federal Re-

serve Board. There are also three members who are prominent bankers of the United States who would be associated with the three members of the Federal Reserve Board in this work. But I have no objection to substituting the Federal Reserve Board per se if it should be desired to have it exercise the licensing power.

Senator STONE. Have you any objection to exempting from the provisions of this bill the securities of municipalities from the license function?

Secretary MCADOO. I think that would be very objectionable. I think that is one of the places where we need to exercise a fair measure of control.

Senator SMITH. Not the States, but the municipalities.

Senator LODGE. It is needed there more than anywhere else.

Secretary MCADOO. I have had a number of cases put up to me of municipalities where obviously the thing proposed was not needed either in the interest of the public in time of war or in the interest of health. This is exactly along the line of public buildings which the Government of the United States is putting up. I took the liberty of writing a letter to every member of the House and of the Senate in whose district or in whose State there were uncompleted public buildings or buildings authorized and not begun explaining why it was necessary to postpone such construction until the return of peace. Every Senator and every Member of the House, with the single exeeption of one, who did not object but was very anxious that I should except his particular project, agreed with me. Here is the point: There are many municipalities in the United States where there is local pressure for some new building or for the pavement of some street.

Senator WILLIAMS. Or put up new monuments.

Senator LODGE. And they are spending somebody else's money. They are very ready to issue loans.

Secretary MCADOO. Exactly; and unless you can get some measure of restraint I think you are not going to be able to control them, and I think it is very necessary to control them. The only way is to provide that banks which are selling securities shall take a license, and if they then sell securities which they ought not to sell you can punish them. Then you can get control.

Senator TOWNSEND. Would that cover a case like this: Suppose a bank takes a State authorized issue of bonds, would it prevent that bank from rediscounting them at the Federal reserve banks?

Secretary MCADOO. Yes, I think so, Senator.

Senator LODGE. Under this bill it would.

Secretary MCADOO. We could not prevent the bank from buying the bonds.

Senator TOWNSEND. They could not rediscount them?

Secretary MCADOO. They could not rediscount them or resell them.

Senator SMOOT. And the bank would never take them.

Secretary MCADOO. And that would give you the power of compulsion over the unwise use of municipal funds.

Senator SMOOT. Just the same as it would over all the other funds if it were voluntary.

The CHAIRMAN. Mr. Secretary, do you wish to say something with reference to the suggestion that has been made by certain bankers

to the effect that this large authority to issue bonds and securities by the corporation might possibly lead to inflation? I think you referred to that generally the other day.

Senator STONE. I think he covered that.

The CHAIRMAN. Mr. Harding discussed it very fully. I did not know whether you wanted to say anything further about that or not, Mr. Secretary.

Secretary MCADOO. I do not know that I can add anything, Senator, to my statement, where I thought I covered it rather definitely. I do not think it will lead to inflation. On the contrary, I think the tendency would be to restrain inflation, because the whole plan is based upon an unusually sound principle. There will be no inflation of currency resulting from this, in my judgment, and I do not believe it will result in an inflation of credit, especially with the license system, which will restrain injurious capital issues.

Senator WILLIAMS. Which will result in a direct restriction of inflation of securities.

Secretary MCADOO. Precisely, and yet at the same time it will preserve what I think is very essential in the situation and bring about a sound expansion of credit which is absolutely essential to the conduct of this war. You can not carry on this war without an expansion of credit.

Senator LODGE. Credits are enormously inflated now.

Secretary MCADOO. No; they are not.

The CHAIRMAN. I entirely agree with you in what you are saying, but an article has been written by Mr. Roberts, of the National City Bank of New York, which I have reason to believe has been given very wide circulation among bankers. Some things have come to me which would indicate that they had received that article and that it had made quite an impression, and therefore I thought under those circumstances it might be very well to give you an opportunity to further fortify, if you wanted to, your rather brief statement in your written testimony.

Secretary MCADOO. I do not know of any subject you can throw into the arena of debate upon which you can get more discussion and theory than the question of inflation. It is largely a matter of opinion. The City Bank circular to which you refer I have not been able to read, except a part I saw in a newspaper. What I read led me to believe that the author of that circular had not read this bill, or, if he had, that he did not understand it.

It is a question very largely of opinion, gentlemen. It is easy to theorize, and, when one lacks argument, it is easy to obscure the issue by the cry of inflation. Perhaps it may be useful to refer to the discussions with respect to the enactment of the Federal Reserve Act itself. The National City Bank opposed that act strenuously, because, they said, it would lead to inflation. Nearly everybody in Wall Street had the same view and opposed the Federal reserve law. Subsequent events and experience have shown that they were utterly mistaken. I am stating these facts because so frequently men conjure up fears of inflation and allow them to control their judgments to an undue extent. We have got to take the chances of inflation in this war, anyway. We must have expansion of credits instead of inflation, if possible, and the thing to do is to pass measures which

will give direction to a sound expansion of credit and supervision of it in such a way as to minimize the possibilities or the evils of inflation. In other words, to make it just as sound as we possibly can, and I think this bill does exactly that thing.

Senator LODGE. There is a very broad distinction between expansion of credits and inflation of the circulating medium.

Secretary MCADOO. I agree with you. You must have expansions of credit.

Senator LODGE. I agree with you there.

Secretary MCADOO. You can not finance this war without them. Let us make the expansions of credit as sound as we can.

Senator WILLIAMS. What you want to do through this bill is to make whatever expansion of credit does take place take place in the right direction and restrain the expansion of credit in the wrong direction?

Secretary MCADOO. Exactly; and to make the expansions of credit upon a sound basis.

Senator LODGE. What the bankers are talking about is inflation.

Secretary MCADOO. I am coming to that. There is a chance for the issue of currency by Federal reserve banks against the notes of the banks secured by the bonds of this war finance corporation, and that is the basis for the fear that there may be inflation of the currency. That is so guarded under this bill that the Federal reserve banks issuing such notes must have a 40 per cent gold reserve against them, just as in the case of commercial paper, and all the regulations which apply to the Federal reserve notes will apply. There is also the power of special taxation against an issue of this particular form of currency. You will recall that under the Aldrich-Vreeland Act the issues of emergency currency by the national banks through their national-currency associations were based upon securities of a similar character—I mean fixed investments—and there was no gold reserve at all against such issues. When they were issued in 1914 the Secretary of the Treasury had the sole power to issue over a billion of such circulation with merely a redemption fund of 5 per cent in gold. It was on my insistence that the law was amended to call for an additional reserve of gold, up to 100 per cent if necessary. I issued $384,000,000 of such circulation without any gold reserve.

Senator LODGE. Do you mean that the gold limitation applies to notes issued on these bonds of the corporation?

Secretary MCADOO. The gold reserve which the Federal reserve banks must have against all Federal reserve note issues applies to notes issued against the notes of banks secured by the bonds of this corporation.

Senator LODGE. They must have the 40 per cent of gold.

Secretary MCADOO. Yes. The 40 per cent of gold fixes an absolute limitation on the total issue of Federal reserve notes.

Senator WILLIAMS. In addition to the 40 per cent of gold back of this, is the bond of this corporation secured by the Federal Government?

Secretary MCADOO. Yes; and secured by the collateral deposited against the notes, which the banks rediscount with the Federal reserve banks.

The CHAIRMAN. Mr. Secretary, I understood you to ask that several utility men be heard.

Secretary MCADOO. There are some gentlemen here representing public-utility corporations who wish to be heard.

Senator SMOOT. I wanted to ask the Secretary some questions on Paragraph B of section 6, but I have not the time now.

The CHAIRMAN. The committee will adjourn until 10 o'clock to-morrow morning, when we will hear these gentlemen.

(Thereupon, at 12.05 o'clock p. m., the committee adjourned to meet at 10 o'clock a. m. to-morrow, Tuesday, February 12, 1918.)

THE WAR FINANCE CORPORATION BILL.

TUESDAY, FEBRUARY 12, 1918.

COMMITTEE ON FINANCE,
UNITED STATES SENATE,
Washington, D. C.

The committee met, pursuant to adjournment, at 10 o'clock a. m., in the committee room, Capitol, Senator F. M. Simmons presiding.

Present: Senators Simmons (chairman), Williams, Thomas, Gore, Jones, Gerry, Lodge, McCumber, Smoot, Gallinger, and Townsend.

Present also: Mr. S. R. Bertron, member of the Excess Profits Tax Advisory Board.

The CHAIRMAN. Mr. Bertron, I think we promised to hear you this morning.

STATEMENT OF MR. S. R. BERTRON, BANKER, OF NEW YORK AND PHILADELPHIA.

Senator TOWNSEND. Whom do you represent?

Mr. BERTRON. I am a banker of New York and Philadelphia. I have no affiliation with the Government except I was recently on a diplomatic mission to Russia, and I am now on the Excess Profits Tax Advisory Board. I was asked to come here—I do not know just why—to discuss this matter with you, but not that I am an authority.

The CHAIRMAN. The Secretary asked you as a representative of the banking interests?

Mr. BERTRON. I think so; yes. I have no affiliations with the department other than that which I have stated. I have kept rather closely in touch with the financial situation here and in New York, by reason of my interests. When the Government preempted the market for securities and that fact was realized by the financial community immediately it was the expectation that some measure to care for the necessary corporate financing would be enacted, as has been the case in England and France and other countries. Our railway situation and our public-service companies were the two most important interests that required attention, especially so because of the fact that they have insufficient rates of income to offset the increased expenditures and costs which the war brought on, and their net earnings, therefore, were continually going down, and they were unable to make a financial showing sufficient to borrow money, many of them even in good times. The railway situation will have been cared for, in the eyes of the financial world, satisfactorily when some measure such as that now before you has been enacted. That leaves the public-service companies and other corporations which have a

large maturing indebtedness with no means whatever of caring for these obligations. The public is not buying. The private bankers can only buy a limited amount unless they can pass it along. The banks, by force of circumstances, have been discriminating against advances other than those which are rediscountable at the reserve banks, which is very natural, so that the situation of the country became very, very critical in the autumn.

Senator McCUMBER. The banks want something they can convert into currency?

Mr. BERTRON. Yes, sir; they can not load up on stuff that can not be converted. The situation became very acute in the autumn; the common stocks of the 12 leading railways depreciated to the extent of about 53 per cent of the height they had maintained a few years ago.

Senator SMOOT. Common stock?

Mr. BERTRON. Yes, sir.

The CHAIRMAN. You are speaking of the railroads?

Mr. BERTRON. Yes, sir.

The CHAIRMAN. What years do you mean?

Mr. BERTRON. I have taken the years 1908 and 1909—along there. Those were normal times, we may say. The public service company stocks have continued to depreciate in just about the same proportion. That showed, you see, a very serious situation. People were afraid to buy the securities of these companies because they could not see how their obligations would be financed. The whole financial community has been urgently expecting some measure to cure the situation, and when this proposed bill we are discussing was introduced the idea was, of course, very warmly applauded, and I have not heard of many criticisms of the bill after it was properly understood. A number of our New York bankers at first made some criticisms, and there were criticisms from other parts of the country, but I think to-day the consensus of opinion is that the bill is a very good one as now drawn.

There are only two points about which I think there is very much discussion to-day, and one is the subject that you thrashed over so carefully yesterday with the Secretary—that of giving the bank the right of limiting the issuance of securities by compulsion. A great many people thought it might be very much wiser if in each reserve district a committee of bankers or business men was formed to cooperate in conjunction with the reserve bank of that district having, say, some member of that reserve bank sit on that committee and that committee pass upon the eligibility of the securities to be issued. That, it seems to me, would be an excessively wise provision for two reasons. In the first place, such a local organization would be in better touch with the necessities of the community than an institution here in Washington could be.

Senator TOWNSEND. Why do you call it excessively wise? You favor it?

Mr. BERTRON. I think it would be very wise. That is my judgment.

Senator TOWNSEND. I thought you meant it would be too wise.

Mr. BERTRON. No; because any board sitting here in Washington would fail to keep in touch with the necessities that arose in the various communities. That is necessarily so.

The CHAIRMAN. Has your attention been directed to the provision of the bill which authorizes this corporation to establish branches?

Mr. BERTRON. Quite so. I was just coming to that, Senator, and was going to say that the Secretary explained yesterday very fully to us that he had already begun appointing, through the reserve banks, such committees in the various centers and stated that he proposed under that enactment, if passed, to utilize these committees now being appointed in the reserve districts for that purpose. If that were done I am sure it would meet with quite universal approval, because if the bank of four directors were to attempt to sit here in Washington and pass upon the necessities of every locality I doubt if they would have any time to do anything else, because there would be a vast amount of applications, and local boards would be very much better in touch with conditions.

The CHAIRMAN. I thought the Secretary made it quite clear yesterday that the corporation as such had no purpose of undertaking that particular line of inquiry but they would probably utilize this committee that he has voluntarily created as a part of the Federal Reserve Board; that is to say, three members of the Federal Reserve Board are to be members of that committee, with three outside bankers. That is a voluntary organization, but I understood the Secretary to say that it was his expectation that that organization was to be used in connection with this work.

Mr. BERTRON. Quite so. And I understand they will also have similar organizations in each of the reserve districts, and if the Secretary will utilize, in case this bill passes, those organizations which are now representing the reserve banks that will be utilized for this purpose, that would meet this objection.

The CHAIRMAN. This bill merely gives the power to the corporation.

Mr. BERTRON. Quite so.

The CHAIRMAN. But it exercises that power through these committees.

Mr. BERTRON. Quite so. And I say the fact that the Secretary expects to do that will be excessively helpful and will meet with general approval.

Senator SMOOT. Those local boards will not have the power to pass upon the loans?

Mr. BERTRON. They will pass upon the eligibility of the local corporation, or, I imagine, issue a certificate, or recommend it for action here by the board. That would answer the purpose entirely and obviate any criticism I have heard of that character.

The CHAIRMAN. What do you think of this suggestion? It is one I made to the Secretary yesterday after we had discussed this matter and adjourned. That committee is now a mere voluntary committee. It has no legal status. If we should pass the bill as it is now written, that committee would still have no legal status. To meet the apparent objection of some members of the committee yesterday I suggested that it might accomplish the general purpose just as well to lodge the power of ultimately determining whether the securities should be issued or not with the corporation, but in the bill authorizing the corporation to appoint a committee on capital issues, if you want to call it that, or whatever you want to name it, composed of so

many members of the Federal Reserve Board and so many outsiders, with authority to make these investigations and make findings, subject to the approval of the board of directors of the corporation.

Mr. BERTRON. In other words, you would utilize the idea the Secretary has in mind?

Senator SMOOT. I do not think that would help the situation at all unless they had the power to pass upon the issue.

The CHAIRMAN. Preliminarily they would have the power, subject to the approval of the board. I am just suggesting that. I do not want to stop to discuss that now.

Senator SMOOT. I understood the Secretary to say he had no objection to allowing the Federal Reserve Board to pass upon these issues.

Mr. BERTRON. If it was stated that that was going to be done, I think it would popularize the measure.

The CHAIRMAN. Would it be your idea that the local committees should have the final determination?

Mr. BERTRON. It would be a great mistake, I think.

The CHAIRMAN. Without any power in the corporation?

Mr. BERTRON. I think the final decision should be here.

The CHAIRMAN. If you create them and invest in them the power of decision then you refer this whole matter to two different organizations.

Mr. BERTRON. That would be a great mistake, I think.

The CHAIRMAN. And then they would not articulate this matter with the Treasury.

Mr. BERTRON. The fact that the local committees had passed upon the matters and made recommendations woud be exceedingly helpful.

The other point that was under discussion quite considerably and which might have been discussed here, though I have not heard it, was as to the number of directors of the proposed institution. A great many bankers feel that the purpose of the institution to serve the country at large would be considerably augmented by having several outside directors who would be members and bring in fresh ideas, and who would not be excluded from remaining in business, although not eligible to pass upon securities in which they themselves were interested; and yet if you had a large board it might complicate matters very much in the operation here, and I think those suggestions could also be met, and admirably met, by having, say, an advisory council selected from five or six men from various parts of the country, who would sit once in so often with the board here, with the directors, to act in advisory capacity, which would enable the directors here to keep in touch more closely with the various districts from which they came. I think such a suggestion as that would popularize the measure and add to it sufficiently without making it cumbersome by having too many directors.

Senator WILLIAMS. What is the use of an advisory committee if it does not do anything but criticize, and suggest, and raise debate, and cause delay?

Mr. BERTRON. None, unless they were business men; and in that event I think they would cooperate most closely with the directors here and keep the directors in touch with the various conditions throughout the country.

Senator WILLIAMS. That is true of ordinary business transactions where there is plenty of time, but in a state of war we have got to act quickly.

Mr. BERTRON. That is true.

The CHAIRMAN. Did I understand you to say that the number of directors of the corporation should be increased?

Mr. BERTRON. No, sir. I have merely stated to you the several criticisms that were made against the bill in various banking centers, and I think they both would be met, the one by carrying out the Secretary's suggestion of yesterday and the other by possibly having four or five advisors, such as you have in the case of the Reserve Board.

Some people have questioned the amount involved, but I think when it is understood that we can not tell what the length of the war will be and we do not know absolutely the amount of obligations to be cared for, the limit put in the bill is none too large. The mere fact that you provide a cure for the whole situation as it appears to the financial world will bring about less necessity for using the bank than if it were limited. For instance, I was active in the formation of a cotton pool that we organized at the beginning of the war. Cotton, as you know, had dropped to under 6 cents a pound, and it is our largest export commodity, and the balance of trade was seriously affected. We organized with considerable difficulty a cotton pool the summer war began and raised eventually $135,000,000 for that purpose. The mere fact that such a thing had actually been accomplished and was in existence satisfied the public anxiety as to the situation, and from that moment the price of cotton began to go up, and there was never utilized but $35,000 of that $135,000,000 provided. The mere fact of its existence answered the purpose.

Senator SMOOT. There were other contributory causes at that time?

Mr. BERTRON. Well, there are always contributory causes, but that was the principal one, and the fact that you establish such a financial institution here will satisfy the public.

The CHAIRMAN. You mean to say those contributory causes would not have produced that result but for this pool?

Mr. BERTRON. Oh, no; the business world is largely governed by sentiment. It is the same with the savings banks. If the depositors know you have the money, they do not want it. If you create an institution that will care for the necessities of the situation and do it promptly, you will obviate to a great extent the necessity of using the institution. There are about $800,000,000 of maturities coming due which must be cared for.

The CHAIRMAN. How many did you say?

Mr. BERTRON. About $800,000,000.

Senator GORE. Do you have any idea of the ratio of those coming due in the year, as compared with the capital?

Mr. BERTRON. That varies with the character of the securities and the industries. In the public service companies, for instance, they have maturities this year of $232,000,000, and it is estimated that the normal expenditures would be nearly three times that, but those expenditures can now be greatly reduced because many of them are unnecessary.

Senator GORE. It is estimated that the renewals will be about 30 per cent of the entire amount of capital needed, including renewals and new capital?

Mr. BERTRON. That is approximately correct, sir.

The CHAIRMAN. Have you any further statement to make, Mr. Bertron?

Mr. BERTRON. No, Senator; not as applying directly to this measure; but I would like to say this: If we could bring about the realization throughout the country of the necessity of avoidance of unnecessary expenditures we would accomplish a very great need. This measure will take care of and prevent unnecessary issuance of many securities. It is limited now to $100,000 in amount, but I think that far in excess of anything that would come under this bill is expended yearly in smaller amounts throughout the whole country. To give an illustration, in a certain city in the West, where I was recently, a number of the people have made a great deal of money since the war has begun, and a great majority of these people are building fine houses. Now, they do not realize that the building of those houses may result in the loss of efficiency of the American Army or the death of their sons or some member of their family. If they realized that, they would not go ahead with these unnecessary expenditures which can just as well be postponed. They employ labor which is needed elsewhere, they employ material and transportation which is needed for war purposes. That thing is going on all throughout the country, and in the aggregate it amounts to infinitely more than the amount of maturities that we are now considering in the case of corporations.

Senator LODGE. Do you think there is any considerable amount of that building?

Mr. BERTRON. Yes, sir; it is very general, and many of our cities even yet have not begun to realize the necessities of the situation. In one city I have in mind they wanted to do $500,000 worth of paving. They could get along just as well without that paving, which takes labor, which takes material and credit; and if some of these things are postponed until after the war is would make a great difference.

Senator LODGE. My question was confined to building new private houses. I did not suppose there was very much of that going on.

Mr. BERTRON. I can name one city in the Middle West where a great number are going up, and it is so all over the country. They are not spending large amounts in each case, but in the aggregate these things mount up enormously.

Senator SMOOT. It is not so in the Rocky Mountain States. In fact, building is at an absolute standstill.

Mr. BERTRON. This is beginning to be understood——

Senator LODGE. They say there is very little in the East as compared with the usual amount of building.

Senator GORE. Do you understand this bill to cover the cases of private individuals?

Mr. BERTRON. I think when this gets in operation in large measure the reaction will be so great that even though it does not give power to do such things, in effect it will do so.

Senator LODGE. This would not touch that case.

Mr. BERTRON. It might sentimentally.

Senator GORE. Do you think the licensing provision and the limitation should apply to the payment for stocks and bonds made in liberty bonds?

Mr. BERTRON. I should give this bank a very wide authority, and the wider the authority the less it will be used, the less will be the necessity for its use.

Senator SMOOT. The less it ought to be used.

Senator GORE. It might relieve the strain on the money of the country and allow it to be devoted more largely to liberty loans.

Mr. BERTRON. In a small way; but in large issues it would not be practicable.

Senator SMOOT. Do you recommend that that $100,000 be reduced?

Mr. BERTRON. No, sir; I do not; because the work would be too great.

Senator MCCUMBER. Before you get through, I wish you would give your opinion with reference to the provision for assisting corporations and individuals and lines of business by furnishing them capital, etc., that which seems to be the principal object of this bill and yet which we have hardly had discussed.

Mr. BERTRON. Omitting the railroads from this discussion, the next large number of maturities are those of the public-service corporations. They are sadly in need of assistance, because their rates have not been increased and their costs have gone up enormously, and they are having a very serious time. Several important ones have already failed, and others will follow unless relief is administered. Then there are a number of commercial corporations in need of assistance; there are some corporations that it will be good judgment to aid and assist, even a number that are not directly of service to the Government. But, after all, we want to preserve the credit of sound business in the country, even though it is not immediately available for the purposes of the war.

Senator MCCUMBER. Could not that situation be partially met by allowing the service corporations to raise their rates in accordance with the cost of labor and materials?

Mr. BERTRON. That would be necessary in any event, because unless they had earnings they would not be able to borrow from this institution. But that does not provide the money for their maturing obligations.

Senator WILLIAMS. That would not float their bonds?

Mr. BERTRON. No, sir. Ordinarily, a banker could buy the securities in the case of ordinary commercial organizations and make a public offering to his clients and resell them.

Senator GORE. You speak of ordinary commercial organizations. Do you not think it would be better to let them go to the banks and let them approach this corporation through the banks?

Mr. BERTRON. I think that is contemplated.

Senator GORE. Subdivision D, section 6, does not do that, and will invite Tom, Dick, and Harry to go direct to this corporation.

Mr. BERTRON. Does not that say in exceptional cases?

Senator GORE. But every man thinks his case is exceptional.

Mr. BERTRON. There are exceptional cases that we must provide for.

Senator GORE. Could we classify this; say public-utility or public-service corporations?

Mr. BERTRON. The only difficulty in classifying them is that some very deserving case will arise which you will not have classified and you will force him to go to his bank and pay a double tax.

Senator GORE. There will be a horde of undeserving cases, and probably the undeserving ones will be more persistent in approaching this board.

Mr. BERTRON. A classification might be very useful, but the danger is you may omit some case which should be included.

Senator GORE. It seems to me the principle is very wrong to invite them to come at all.

Senator SMOOT. The Senator is speaking of paragraph D, section 6. I had hoped that I could have the Secretary of the Treasury explain just what his idea was as to that part of section 6. It seems to me it could be abused most outrageously.

Senator GORE. It would subject the board to unexampled pressure.

Senator GALLINGER. Could you give us a concrete illustration of what you would call an exceptional case? This applies to individuals as well as to corporations. The Secretary of the Treasury suggested that farmers might be included.

Mr. BERTRON. I will give you one in connection with public-service corporations. There is a corporation in New York that has maturities coming due this year of somewhere in the neighborhood of $20,000,000, supplying an enormous number of people and serving a large community. It is excessively helpful in the work of the war, supplying power to factories, and in other ways, and they have these maturities coming due. It would be perfectly impossible for those securities to be offered and sold to the public to-day.

Senator SMOOT. But that is covered in subsection B of the bill. That reads—

> To make advances, upon such terms not inconsistent herewith, as it may prescribe for periods not exceeding five years from the respective dates of such advances (1) to any bank, banker, or trust company which has made and has outstanding any loan or loans to any person, firm, corporation, or association whose operations shall be necessary or contributory to the prosecution of the war—

And so forth.

Mr. BERTRON. But does not that mean those advances are merely made through intermediary banks with a margin of security provided? It is a question just what that does mean.

Senator SMOOT. They can only advance up to 75 per cent of the security that they offer.

Mr. BERTRON. Now, it may be very desirable for the banks to buy outright the securities, provided they are amply secured and safe.

Senator SMOOT. And it says:

> (2) To any bank, banker, or trust company which has rendered financial assistance, directly or indirectly, to any such person, firm, corporation, or association by the purchase of its bonds or other obligations.

The public utility you mentioned has sold its bonds?

Mr. BERTRON. They might very properly come to this institution and say, "We can not get accommodation elsewhere; we would like to borrow this money from you," and deal directly with it.

Senator SMOOT. If that is the case, why have anything else; let them all go there.

Mr. BERTRON. Many cases might be refused by banks, and then this institution would immediately step forward and substitute its place for that of the bank.

Senator SMOOT. Either one or the other of these provisions is not essential.

Mr. BERTRON. No; I think they are both essential. In one case the bank would take the securities and borrow from the Government institution on the same basis, putting up the same margin; but in many cases it would be very much better if the corporation, instead of seeking and possibly failing to find bankers who would advance the money, could go directly to this institution and pledge its credit and get this money. Those are the exceptional cases.

Senator SMOOT. I do not know of any public institutions now that would come under that exception. Of course, if you wanted to be forming new corporations, they would come under that provision, but all that are formed now have placed their bonds on the market, and this is for the refunding of those bonds, and it does not seem to me there is any necessity to go direct to the corporation.

Mr. BERTRON. But those bonds are now in the hands of thousands of investors throughout the country, and they are becoming due, and each man wants his money and expects to get his money.

Senator SMOOT. And he could do that under paragraph b, section 2.

Mr. BERTRON. Then he would have to get some bank to advance the money.

Senator GALLINGER. Where would you draw the line of demarcation? You are going to be undoubtedly pestered by nearly every broken-down public-utility corporation in the country for help, and by every individual, for that matter. Where are you going to draw the line; will it not be difficult?

Mr. BERTRON. I think, except in exceptional cases, these applications are provided to come through banks and bankers.

Senator GORE. If this were limited to refunding operations, would not that meet it?

Mr. BERTRON. Not absolutely. There is a certain amount of new work that must be done for war purposes. Public-utilities corporations must extend their plants in the case of certain cantonments; they must increase their power in order to supply factories with power, and in order to get employees to work, and the Government is seeking to get them to increase their power facilities so they can get more power for munitions work, and so on, and there would be quite a large amount of money needed for war purposes that can not be avoided if we are going to properly prosecute the war.

The CHAIRMAN. The Secretary of the Treasury in his written statement filed with the committee the other day, in referring to this provision in regard to exceptional cases, dismisses it with this general statement:

> The provision permitting direct loans by the corporation in exceptional cases is intended to provide for those rare instances where it may be made to appear to the corporation that a meritorious borrower is being unwisely or unjustly discriminated against by the banks.

That is all he said about that.

Senator WILLIAMS. That gives this man two alternatives: He goes to the bank, and if the bank wants to fleece him he can go directly to the corporation.

Senator SMOOT. That is a very dangerous situation.

Senator GORE. That policy is a great deal easier to start than to stop.

Mr. BERTRON. You will find a good many cases where it will be necessary.

Senator GORE. If this policy succeeds in time of war, do you believe the people will be willing to stop it in time of peace? If the public can go to the Government in time of war, and the Government can rescue borrowers in time of war from overexacting bankers, do you think they will be willing to stop that in time of peace?

Mr. BERTRON. It would be a satisfactory solution for the public at large, but we are only considering this as an emergency measure.

Senator GORE. It is based on the theory that there are bankers who are Shylocks. That is not a war emergency; that exists in time of peace. It is as old as the practice of lending and borrowing money.

Senator WILLIAMS: This is intended to take care of these very exceptional cases, and a majority of these cases will be corporations which are doing work which is important to aid in the work of the war, and their activities will cease to be accentuated during peace times. Those are the men we want to keep from the grasp of the Shylocks, as you call them.

Mr. BERTRON. A number of munition factories that are absolutely necessary in war work can not get help from the banks.

Senator GORE. There have been in time of peace very widespread organizations insisting that the Government lend money to indivdauls on their cotton—they have tried to get the Government to buy seed—and I think we ought to discourage the policy of borrowing from the Government. I have always objected to doing things of that kind because I keep constantly in mind the old Roman practice of selling grain to the people at less than cost and then giving it to them. I think that undermined the minds of the Roman people.

The CHAIRMAN. Why should you have any fear that this should be continued in peace times? The very basis of the whole measure is that the money is to be loaned only to that class of industries whose operations are connected with the war—are contributory to the war.

Senator TOWNSEND. I understood the example that Mr. Bertron gave off the record was not a war corporation.

Mr. BERTRON. Oh, yes; they are doing war work. They are supplying heat and power for war work, but it might happen that it would be unwise not to help a corporation that was not doing war work.

Senator GORE. Here is an illustration, and it is characteristic of every relation of creditor and debtor between the individual and the Government: The people bought homestead land, and every time maturities approached they have insisted upon an extension of time, and Senators or Congressmen where those cases arise must obey the dictates of those people or they will not be returned to office.

The CHAIRMAN. You would not suggest, Senator, that because the thing would be bad to do in peace times that we ought not to do it in war times if it seems to be necessary?

Senator GORE. Undoubtedly necessities arise in war that must be met, but I am not sure that this is one. It looks to me like the ordinary credit agent, the banking house, is an agency or intermediary between the borrower and the corporation which should be utilized. The corporation will be overwhelmed with many worthless exactions, and the more worthless the more exacting they will be.

The CHAIRMAN. My understanding is that the very thing that brought about this suggested legislation originated in the situation that confronted the banks. It was made known to the Treasury, and I think the banks probably suggested that they were not in a position to handle these loans. They suggested to the Government some means by which the Government might supplement their funds.

Senator LODGE. The trouble is fundamental, and it is that people are very ready to spend the money of the Government; that is, the money of other people. They are much more ready to lend it than when they are lending their own money, and they do not take the ordinary precautions under those circumstances. That is the trouble. If you have got to take the money out of your own pocket you are very careful; but here you are lending money which belongs to somebody else.

The CHAIRMAN. You are speaking of the exceptional cases.

Senator LODGE. I am speaking of any case. The danger I apprehend in this bill is that this corporation is going to be overwhelmed with every kind of wild-cat scheme which will come here and make some plausible representation that they are working for the Government; and you will find that these exceptional cases will be the rule.

Senator WILLIAMS. That all depends upon the common sense and the perspicacity and business ability of the men who are going to handle it.

Mr. BERTRON. That is it.

The CHAIRMAN. That might be true, and it might be dangerous if it were true that this exception was going to be the rule. The corporation will not loan the money to the industry needing it; the bank will first loan the money. The bank will not be lending somebody else's money; the bank will lend its own money, and if it loans its own money then it will come to the Government and ask the Government to rediscount.

Senator LODGE. That is a different thing.

The CHAIRMAN. The bank is a protection against those wild-cat projects.

Senator LODGE. I am speaking of the class to which they loan directly.

Senator WILLIAMS. That provision is intended to meet cases where people are doing very important work for the Government in the carrying on of the war and where they perhaps need money in order to perfect the plant and to keep it operating. Here is a case, for example, up here, where they could not carry on work because they did not have housing facilities for the workingmen. That is a case where the Government ought to step in and deal directly through the corporation, because they are making munitions and building ships, and so on; and we can surely trust to the common sense of this board not to go into ordinary busines stransactions under that clause.

Senator SMOOT. Let me call your attention to the looseness of this paragraph D. Paragraphs B and C provide that this corporation shall not only have the securities put up by the party that shall get the money, but shall have the indorsement of the bank back of it, and that only 75 per cent shall be issued on the amount of the face of the securities, both in the case of savings banks and the institutions and individuals that borrow through the banks. Now, the Government is perfectly secure there, because the banks will see that no chances are taken.

The CHAIRMAN. They are loaning only 75 per cent of the amount?

Senator SMOOT. Not only that, they know they have got to go and get the money from this corporation. Let me read section D [reading]:

(*d*) In exceptional cases, to make advances directly to any person, firm, corporation, or association whose operations shall be necessary or contributory to the prosecution of the war, for periods not exceeding five years from the respective dates of such advances, upon such terms and upon the security of such bonds, notes, or other obligations, and subject to such rules and regulations as may be prescribed by the board of directors of the corporation, with the approval of the Secretary of the Treasury. The corporation shall retain power to require additional collateral security at any time.

In other words, the savings banks have got to put up 125 per cent, and the banks can only secure 75 per cent of the face value of the security, but in this case there is no limit at all; they can issue 100 cents of the notes, or bonds, or obligations, according to this section D.

The CHAIRMAN. Let me make this suggestion: When we have finished the hearings and are ready to begin the consideration of the bill then, I think, we might consider the question of amending those sections. For instance, instead of leaving it to just a broad declaration of a general case, we might undertake to define what an exceptional case is if we want to, in the amendment. We might go further; we might provide that the security should be the same proportion in the exceptional case as in the ordinary case. That is a matter, however, for determination when we get into executive session.

Senator SMOOT. The only reason I spoke of it was that it was under discussion.

Senator WILLIAMS. I want to impress upon the committee the class to which this applies, and only to that class: "In exceptional cases, to make advances directly to any person, firm, corporation, or association whose operations shall be necessary or contributory to the prosecution of the war."

Senator LODGE. That covers every conceivable case.

Senator WILLIAMS. Here is a case that happened near here not long ago, one of the wealthiest corporations in the country, the Schwab Steel Co., not far from Baltimore. They wanted to get advances for the purpose of housing their workingmen; they had to provide for an increase of their forces. Everybody knows that institution is perfectly good, and it could go into the market and get the money with some bank behind it, but it would have to pay a very high interest. And that is not all. One of the large shipbuilding companies on the Atlantic coast was in the same sort of fix. Now, that would require more than this percentage, and yet,

in the long run, the company is perfectly safe. The investment is perfectly good, but if you bound them down to this percentage that you have in the balance of the bill they could not all at once, in one year, do the things necessary in order to go to work at once. This is a war-emergency measure.

Senator GALLINGER. At the present moment that condition exists on the Atlantic coast. In Portsmouth, N. H., they have not sufficient housing facilities, and the Government has put up some for them.

Senator SMOOT. I do not think that the Senator thinks that the Government ought to put up 100 per cent on all that people say it is going to cost to do that work.

Senator WILLIAMS. If I had to pay it to make sure of the ships being built, I would pay a hundred per cent rather than go without the ships.

The CHAIRMAN. There are some other gentlemen who want to be heard besides Mr. Bertron. Mr. Bertron, are you through?

Mr. BERTRON. On one point I would simply say that I have not heard that clause criticized in any banking quarter, because I think bankers all realize that this is intended to cover emergencies, and that some such provision is very essential. Of course it might be safeguarded to a greater extent, but after all the whole thing depends on the administration of the institution, does it not? If it is wisely administered it will be a success, and if it is not wisely administered it will not be a success.

Senator LODGE. This money does not come out of the air; it has got to be taken out of the people of the United States, and I think it ought to be properly guarded.

Mr. BERTRON. Quite so, sir.

Senator LODGE. We can rely on a man to look after his own interest, but when we are lending the money of others we ought to protect it.

Senator GALLINGER. I sympathize with the suggestion of the chairman that when we come to consider this we ought to throw other possible safeguards around it.

The CHAIRMAN. I understand that Mr. Bertron simply expresses the opinion that there ought to be some provision for exceptional cases. He does not object to any proper definition as to what an exceptional case should be.

Mr. BERTRON. But some exceptional cases will always appear that you would like to care for.

Senator GORE. Would not every exceptional case be subject to rather dubious credit?

Mr. BERTRON. They should not be; if they were, they would not receive recommendations.

Senator GORE. We take it for granted that the ordinary case can be handled at the banks. I assume the banks will accommodate those who have good security and will refer the others to this corporation.

The CHAIRMAN. I understand you to say that you appear as the representative of the banking interests of the country; not delegated, but as one representing the banking interests?

Mr. BERTRON. I assume so. I was asked to give my views.

The CHAIRMAN. You are a banker?

Mr. BERTRON. Yes, sir.

The CHAIRMAN. Do you think you understand the attitude of the banks as a rule with reference not to the details of this legislation, but the general principle and purposes of the bill?

Mr. BERTRON. I do. We have been discussing just some such proposed measure continuously since the war began.

The CHAIRMAN. Many bankers?

Mr. BERTRON. A great many.

The CHAIRMAN. Are you prepared to express an opinion to the committee as to the attitude of the banks with reference to this legislation?

Mr. BERTRON. I think when it is understood there will be an almost universal approval of it.

The CHAIRMAN. Do you mean to say that it is misunderstood by the bankers?

Mr. BERTRON. There were certain criticisms with reference to the two principal provisions I refererd to. One criticism was made, but on understanding the provision the objection was withdrawn. One, a very prominent banker in New York whom I would prefer not to mention by name, when he was first consulted thought it might be wise, for instance, to have the President make the appointments, to be confirmed by the Senate, but afterwards he said he had given it more consideration and he wished to withdraw the statement he had made, and he thought the Secretary of the Treasury would be much more suitable to make the appointments. And one very large bank that had registered objection, after studying the bill has withdrawn it, and I know of no one to-day—there may be, but I know of no one—who is opposed to this measure.

The CHAIRMAN. My question to you was not directed to details, such as the matter of appointment; it was directed to the general purposes and principles of the bill.

Mr. BERTRON. There is a very unanimous approval of it.

Senator GALLINGER. Have you given careful consideration to the clause referring to the sale of bonds?

Mr. BERTRON. Yes; because that is a matter that has given very great concern since the beginning of the war; but it is a matter that it has not been very desirable to discuss publicly, because the less said about the uncertainties of the savings banks the better at the present moment; but it has been causing a very great deal of anxiety.

Senator GALLINGER. Do you think the provisions of the bill are just?

Mr. BERTRON. Yes.

Senator GALLINGER. Of course, you would not limit this time for loans to 90 days?

Mr. BERTRON. I think it is a mistake to limit it.

Senator GALLINGER. The Secretary of the Treasury admitted that, practically.

Senator LODGE. He said he had no objection to making it six months or a year.

Senator GALLINGER. The rate is also regarded by some very wise men as too high.

Mr. BERTRON. As soon as they know they will be amply cared for the necessity will not exist any longer.

The CHAIRMAN. Several times allusions have been made in these hearings to the attitude of a certain very prominent banker in New

York connected with the City National Bank with reference to the danger of inflation through the issue of this large volume of notes by the corporation. Is there any apprehension, any serious apprehension, on the part of bankers that this legislation may result in an undue or dangerous inflation of currency?

Mr. BERTRON. I think not. That is a theoretical statement which is usually made, and very generally made, and I think the banker to whom you refer to-day would be in favor of this measure.

Senator GALLINGER. You would not contend that there was not under this law if enacted some degree of inflation?

Mr. BERTRON. It depends upon what you mean by inflation. There would be an expansion of credit.

Senator LODGE. No; the inflation of the circulating medium.

Mr. BERTRON. I do not think there is any danger of that. It is amply safeguarded. You must apply to the reserve board, and the reserve board will be careful to guard that.

Senator SMOOT. I can not see why any banker in the United States should object to this legislation. They might object to certain provisions of the bill, and do object to them; but as far as the bill generally is concerned, every banker would be in favor of it, because without legislation of this kind it is absolutely impossible to carry on the business of the Nation.

Mr. BERTRON. Absolutely; and if this could be speedily approved by the Congress it would have a most salutary effect in placing the next Government loan, a very great effect.

The CHAIRMAN. You referred in the beginning of your statement to the very unusual shrinkage in the value of railroad and public-utility securities. At how much did you place the depreciation?

Mr. BERTRON. About 53 per cent at the lowest.

The CHAIRMAN. That you think is due to the feeling of inability on the part of the banks to properly finance those corporations?

Mr. BERTRON. Not to the banks solely, but to the public at large, which felt that the properties were not showing sufficient earnings to warrant their getting credit from banking institutions or in placing obligations, and they said, "We had better sell and get out."

Senator GORE. That has not been limited to railroads and public utilities?

Mr. BERTRON. Oh, no; they are especially affected, as almost any manyfacturing enterprise gets a large return to offset the additional cost, but the railways and public-service corporations have no increased income and are very seriously affected—more so than any other industry.

Senator GORE. Except in the case of industries pecularly connected with war work, there has been no considerable sale of other securities?

Mr. BERTRON. Yes; because there is less purchasing power.

Senator GORE. I have seen the statement that the railroads have weather the storm better than any others.

Mr. BERTRON. I gave you the statistics with reference to the 12 strongest railroads. The statement would be much worse if they were taken collectively.

Senator GORE. Values have sunk generally; the sea level has gone down.

Mr. BERTRON. The earning power of these corporations has been seriously affected.

The CHAIRMAN. If the members of the committee do not desire to ask further questions we will hear the other gentlemen.

Mr. BERTRON. I am very much obliged to you.

The CHAIRMAN. We will next hear Mr. Gadsden.

STATEMENT OF MR. PHILIP H. GADSDEN, MEMBER OF THE UNITED STATES PUBLIC UTILITY COMMITTEE, CHARLESTON, S. C.

The CHAIRMAN. Please state whom you represent.

Mr. GADSDEN. I am chairman of a committee representing the four national public-utility associations—the American Electric Railway Association, the National Electric Light Association, the American Gas Institute, and the National Commercial Gas Institute.

The CHAIRMAN. They cover pretty generally the public utilities?

Mr. GADSDEN. Practically the entire public-utility interests of America. I suppose, generally speaking, from 85 to 90 per cent of the companies belong to these various associations.

This committee has grown out of the critical situation which faces the public utilities of this country. It has been officially organized by the appointment from each association of representatives, so that we are officially representing, as far as it is possible for an industry to be represented, all of the electric railway, gas, and electric interests of the country. We have had a number of conferences before coming to Washington, extending over the last 60 days, in which conferences the leading men of the industry from all over the United States have taken part, in order to work out a common line of action and policy. This special committee of which I speak is composed of myself as chairman, and E. K. Hall, of the Electric Bond and Share Co., of New York, and Mr. H. H. Crowell, of the Commonwealth Co., of Grand Rapids, Mich.

We were requested to come down to Washington the latter part of December to take up with the Treasury, through the Comptroller of the Currency, the question of what remedy or what relief could be afforded to the public utility interests of this country. At our first conference Gov. Harding, of the reserve bank, was present, and we went quite fully into the situation facing the public utilities as we saw it at that time. The comptroller asked for a mass of information, and we undertook to go off and get that data for him. At subsequent interviews the department asked for additional information, and we have filed from time to time with the department a mass of data regarding the public utilities of this country, all of which is included in this statement, which I would like, Mr. Chairman, to leave with the committee.

The CHAIRMAN. We will have it printed in the record.

(The data referred to by Mr. Gadsden is here printed in full, as follows:)

NEW YORK, N. Y., *January 8, 1918.*

HON. JOHN SKELTON WILLIAMS,
Comptroller of the Currency, Washington, D. C.

DEAR SIR: At our conference in your office on December 29, 1917, with reference to the critical situation facing the public utilities of the country, you requested this committee to furnish you with cerain data, and, agreeable to your request, it is respectfully submitted herewith.

It is the universal opinion of those responsible for the continued operation of the public utilities of the country that, if the impending breakdown is to be averted, there are four phases of the situation which must be taken care of.

1. Rates must be increased sufficiently to absorb the increased costs of producing the service.

2. The utilities must be relieved during the period of the war of all nonessential and unproductive requirements, such as paving, undergrounding of wires, duplication, and unnecessary extension of service.

3. Some way must be found to enable the utilities to take care of obligations maturing while the war lasts.

4. Assistance must be provided to enable the companies to finance the unavoidable extensions of service made necessary by the Nation's war program.

Nos. 1 and 2 are primarily questions to be worked out by the public utilities and the various regulatory authorities of States and cities. The ordinary machinery of readjusting rates, however, is so complicated and open to delay that it is of comparatively little value in the present emergency, unless it can be speeded up by recognition of the paramount issue of the Nation that the credit of these companies and their ability to serve in the present crisis be preserved unimpaired.

Nos. 3 and 4 are so involved with the general question of the Nation's own financial program that we feel in this respect we must rely for suggestions upon the financial authorities of the Government and place the services of our committee and our associates at your command in attempting to work out and cooperate with any plan which may seem to you to meet the situation.

Exhibit A which is attached contains the information, so far as we have been able to secure it, which you requested at our last conference.

Exhibit B shows the results of the operations of companies for certain periods. These results demonstrate the trend of the business, and clearly indicate that the year 1918 threatens more serious results than even the latter part of 1917, when the effect of war conditions began to show itself most seriously upon these companies.

Exhibit C is a statement showing present prices of securities of 17 typical public utilities, as compared with prewar prices. Comparatively few of the public-utility stocks are listed on the stock exchange, but we have taken 17 of the larger companies and prepared a statement along the general line of the tabulation of the stocks of 12 railroad companies which you handed us to indicate the line of information which you wanted relative to public-utility stocks.

Exhibit D has already been referred to.

If there is any further information or data which you may desire, please consider us at your service.

Yours, very truly,

AMERICAN ELECTRIC RAILWAY ASSOCIATION,
NATIONAL ELECTRIC LIGHT ASSOCIATION,
AMERICAN GAS INSTITUTE,
NATIONAL COMMERCIAL GAS ASSOCIATION,
Committee.

EXHIBIT A.

Statistics of operating electric light and power, street railway and gas companies in the United States.

1. Approximate annual gross earnings of electric light and power, street railway, and gas companies of the country	$1,500,000,000
2. Approximate annual net earnings, operating expenses, and taxes of the same companies	(1)
3. Total approximate bonded indebtedness of these companies (including notes payable)	$5,143,765,000
4. Total capital stock:	
Preferred	$1,737,926,000
Common	$4,468,952,000
Total	$6,206,878,000
5. Amount of stock upon which dividends were paid during 1916	$4,321,228,000

[1] On account of there being no governmental agency, such as the Interstate Commerce Commission, from which actual figures or statistics showing the operations of electric light, gas, and street railway companies are obtainable, it is not possible, with any degree of accuracy, to state the approximate operating expenses or net earnings of such companies; therefore, we are showing an accumulation of figures taken from the operations of about 300 gas, electric, and street railway companies as shown on Exhibit B which will reflect a comparison of the operating results of such companies.

6. Approximate annual capital expenditures by these corporations (that is to say, expenditures outside of operating expenses, taxes, fixed charges, and dividend charges)	[1]
7. Approximate amount of coal consumed annually (figures from United States Bureau of Mines)—tons	51,500,000
8. Approximate consumption of copper	[2]
9. Approximate consumption of rails, tonnage	[3]
10. Approximate amount of maturing bonds and other public indebtedness of these corporations for the years 1918–19:	
During 1918	[4] $232,000,000
During 1919	$265,000,000
11. Maximum and minimum rates which are being charged for light and power throughout the country	[5]
12. Approximate average rate which is being charged for light and power throughout the country	[6]
13. Rough estimate as to the increase in the cost of materials which are being consumed annually:	
Fuel—per cent	90–150
Materials—do	[7] 35–300
14. Rough estimate of increased charges being paid for labor now as compared with two years ago, average—per cent	40–50
15. Approximate maximum and minimum rates which are being paid to street-car conductors and motormen now as compared with two years ago (wage rates vary widely with locality, type of operation):	
1915—	
Estimated average minimum—cents per hour	18
Estimated average maximum—do	31
1917—	
Estimated average minimum—do	22
Estimated average maximum—do	35

NOTE.—Actual minimum, 16 cents per hour. Actual maximum, 53 cents per hour.

EXHIBIT B.

Comparative "results of operation" of public-utility companies furnishing electric and gas service and electric transportation.

	1 Gross earnings from operation.	2 Increase in gross earnings over previous period.	3 Operating expenses, including taxes.	4 Increase in operating expenses over previous period.	5 Operating ratio.	6 Increase in operating ratio over previous period.
Year ending Nov. 30:					*Per cent.*	*Per cent.*
1914	$313,070,488	.....	$194,585,084	.....	62.15	.....
1915	318,710,359	$5,639,871	195,241,406	$656,322	61.26	[1] 0.89
1916	353,869,562	35,159,203	221,447,733	26,206,327	62.58	1.32
1917	396,170,942	42,301,380	270,752,138	49,304,405	68.34	5.76
6 months ending Nov. 30:						
1916	179,400,102	.....	113,787,522	.....	63.42	.....
1917	201,143,871	21,743,769	140,127,680	26,340,158	69.67	6.25
3 months ending Nov. 30:						
1916	94,524,566	.....	59,215,496	.....	62.64	.....
1917	105,973,001	11,448,435	73,761,778	14,546,282	69.61	6.97

[1] We estimate that prior to the war approximately $600,000,000 to $700,000,000 new capital was necessary for betterments and extensions, but now that new development has been curtailed possibly as much as $250,000,000 of new capital will be necessary during the coming year on account of demands from shipyards, munition plants, navy yards, cantonments, etc.

[2] Not obtainable.

[3] Since the war there has been a very small amount of new construction work.

[4] Estimate of Moody's Investors' Service $232,000,000
Estimate of Dow, Jones & Co 224,000,000
Estimate of New York Times of Jan. 6, 1917 214,661,000

[5] Rates vary greatly with locality, class of service, type of operating, etc. It would be hard to give a practical estimate.

[6] The statement made in connection with No. 11 also covers this question.

[7] See detailed statement attached to Exhibit B.

EXHIBIT B—Continued.

Comparative "results of operation" of public-utility companies furnishing electric and gas service and electric transportation—Continued.

	7 Gross income from operation.	8 Increase gross income over previous period.	9 Increase in investment account over previous period.	10 Increase in gross income over previous period on old capital if new capital earned 8 per cent.
Year ending Nov. 30:				
1914	$118,485,404			
1915	123,468,953	$4,983,549	$53,898,971	$671,632
1916	132,421,829	8,952,876	70,047,980	[1] 962,880
1917	125,418,804	[1] 7,003,025	108,164,910	[1] 25,571,973
6 months ending Nov. 30:				
1916	65,612,580			
1917	61,016,191	[1] 4,596,389	61,646,947	[1] 13,880,863
3 months ending Nov. 30:				
1916	35,309,070			
1917	32,211,223	[1] 3,097,847	32,504,508	[1] 7,740,084

[1] Decrease.

Number of companies reporting, 316.
Population served, in excess of 20,000,000.

NOTE.—Comparing results for the years 1916 and 1917 we note a marked increase in operating expenses and operating ratio, 1917 over 1916. The situation becomes more acute in the latter part of 1917, with every indication of a worse showing for 1918.

SUPPLEMENTAL MEMORANDUM IN RE EXHIBIT B.

The results shown cover approximately 20 per cent of the industries with a preponderance of electric and gas service over street and interurban service, the reports being from the more prosperous companies.

The increase of "approximately" 7 per cent in "operating ratio" occurred despite the most drastic efforts to reduce "cost" of operations and with a minimum expenditure for "current maintenance and repairs," with corresponding decrease in "per cent condition" of the physical properties.

Amplifying the "results" shown for the last 3 months of 1917 to cover 12 months' operations and 100 per cent of the "industries," using the same ratios, we produce—

Increase in gross earnings	$228,968,700
Increase in operating expenses	290,925,640
Decrease in gross income	61,956,940
Increase in investment	650,080,000

The practical effect of this "trend" is (*a*) to reduce "net earnings" to a point that is less than one and one-half times fixed charges, making it impossible to comply with the requirements of the modern mortgage, so as to finance "extensions" by additional issues of bonds; (*b*) to reduce per cent return on the equities to a point too low to make it possible to establish a market for stock, so as to finance extensions by additional issues of stocks.

SOME INCREASES SHOWN.

The following table of increase will show in part the tremendous added cost burden which must be met in the construction and operation of utilities.

The figures are taken from the Electric Railway Service, published in Detroit, and are on the basis of the respective prices of 1914 and 1916:

	Per cent.
White-oak ties	22
Copper trolley wire	74
Motor equipments	37
High-speed steel	235
Standard body paint	52
Journal bearings for car trucks	62

	Per cent.
Brass castings	80
Gray iron castings	32
Steel castings	50
Structural-steel sections	132
Iron bars	185
Steel bars	235
Cement	60
Gravel	68
Track bolts	55
Sand	20
Leather belt	41
Pig iron	54
Track spikes	19
Machinery cast iron	37

The following table of increase will show in part the tremedous added cost burden which must be met in the construction and operation of utilities.

The figures are taken from the United Railways Bulletin, of St. Louis, and are on the basis of the respective prices of 1915 and 1917:

	Per cent.
Copper wire	180
Pipe, cast iron	100
Axles	272
Acids	162
Bolts	146
Brass	300
Car forgings	216
Castings, malleable	198
Castings, composition	173
Copper, bar and sheet	147
Couplers	106
Drills, all kinds	192
Lead, pig and sheet	127
Nails	110
Car wheels	95
Screws	124
Steel, tool	400
Tie plates	276

The following table of increases will show in part the tremendous added cost burden which must be met in the construction and operation of utilities.

The figures are taken from the sworn evidence in a railway fare case before the New York State Public Service Commission, second district, August 14, 1917, and are on the basis of the respective prices of 1914 and 1917:

Electrical machinery.

	Per cent.
Motors and car equipments	65
Air brakes	60
Rotary converters	50
Transformers	60
Switchboards	75
Motor generators	55
Turbo-generators	100

RAW MATERIALS.

Pig iron	250
Steel plate	700
Copper, 100 per cent	120
Steel castings	90
Steel forgings	350
Spelter	90
Brass	190
Rubber, crude	60
Mica	140
Insulation material, 50 per cent	150
Fuel oil, 60 per cent	65

EXHIBIT C.

Table showing the shrinkage in the common capital stock of 17 leading public-utility companies from the high prices in the last five years to the present low level.

Name of company.	Outstanding common capital stock.	Highest price in last 5 years.	Value on basis of present capitalization and highest price reached.	Recent lowest price.	Value on basis of present low price	Percentage of shrinkage to common stock.	Shrinkage shown by multiplying given decline by present capitalization.
American Gas & Electric Co.	$4,020,350	316	$12,704,306	170	$6,834,595	146	$5,869,711
American Power & Light Co.	8,705,400	90½	7,878,387	35	3,046,890	55½	4,831,497
American Light & Traction Co.	18,681,000	450	84,064,500	178	33,252,180	272	50,812,320
Boston Elevated Railway	23,879,400	114½	27,282,214	27	6,447,438	87½	20,834,776
Brooklyn Rapid Transit Co.	74,455,159	94½	70,173,989	36	26,803,857	58⅝	43,370,132
Commonwealth Edison Co. (Chicago)	45,838,900	155	71,050,295	100	45,838,900	55	25,211,395
Commonwealth Power, Railway & Light Co.	18,585,900	65	12,080,835	30	5,575,770	35	6,505,065
Consolidated Gas Co. (New York)	99,816,500	150½	150,223,832	76½	76,359,622	74	73,864,210
Detroit Edison Co.	25,977,400	149	38,706,326	104	27,016,496	45	11,689,830
Edison Electric Illuminating Co (Boston)	22.528,000	288½	64,993,280	133½	29,990,400	155⅝	35,002,880
North American Co.	29,793,300	81½	24,281,539	39	11,619,387	42½	12,662,152
Northern States Power Co.	6,170,000	107	6,601,900	50	3,085,000	57	3,516,900
Pacific Gas & Electric Co.	34,035,858	68¾	23,399,653	33	11,231,833	35¾	12,167,820
Peoples Gas Light & Coke Co.	38,500,000	129¼	49,761,250	35	13,475,000	94¼	36,286,250
Public Service Co. of Northern Illinois	11,573,900	118½	13,686,136	71	8,217,469	47½	5,468,667
Republic Ry. & Light Co.	6,206,000	56	3,475,360	17	1,055,020	39	2,420,340
United Light & Ry. Co.	6,900,100	55	3,795,055	24	1,656,024	31	2,139,031
Total	475,667,167	.....	664,158,857	.....	311,505,881	74⅛	352,652,976

NOTE.—Percentage of shrinkage to value on the basis of present capitalization and highest price reached is 53.1 per cent.

WAR FUNCTIONS OF PUBLIC UTILITIES.

The whole war program, in which all the industries of the country are now mobilizing, is predicated on continuous and, in most cases, increased service from the public utilities. This fact has just begun to be recognized by the general public.

Electric light and power.—Upward of 60 per cent of industrial or factory power is furnished by public utilities. The present supply is now unequal to the demand because of the speeding up of all industries by reason of the war. The whole speeding up of these war industries is dependent upon obtaining the required additional power from public utilities, it being wholly impossible for these industries to acquire and construct their own power plants, either for their present or for their future needs, in time for the purposes of the war program. It is stated on good authority that practically 20 per cent of the heat required in the manufacture of open-hearth steel is furnished by electricity supplied by public utilities.

It is further stated that practically all of the high-speed steel, the so-called electric steel, is now manufactured through the medium of the electric furnace, which furnaces are operated with electricity furnished by public utilities.

Electric transportation.—By reason of war orders large industries are increasing their output, new industries are springing up in the industrial centers, new industrial centers are being formed to house the army of new workers crowding into them, thus making tremendous demands on present electric railway systems and requiring important extensions and very considerable additions to their equipment, and upward of 80 per cent of the factory employees are transported daily by the electric street and interurban railroads, which railroads move upward of 20,000,000,000 passengers annually.

Artificial gas and coke.—The industrial demand for gas is greater than ever before, there being hundreds of separate uses for this product. Gas works and distributing systems are now wholly inadequate to supply the demands of industrials in the larger centers. The use of gas for cooking and incidental heating

is now almost universal in the homes of the people in all urban centers having a population in excess of 5,000.

By-products.—The companies manufacturing coal gas produce one-half ton of domestic coke for sale to the householder for every ton of coal carbonized. They are also producing large quantities of ammonia and may be depended upon for a substantial supply of toluol, under suitable standards.

It is estimated that the by-products coke-oven plants will be unable to furnish more than three-fourths of the Government's demand for toluol in the year 1918.

The deficiency must come largely from the artificial-gas plants, when proper methods are had.

In order to furnish this deficiency, estimated at 8,000,000 gallons, it will be necessary for all gas plants operating in cities having a population of 40,000 and over to plan for the recovery of toluol is incidental to their general purpose of furnishing artificial gas and coke for range cooking, house heating, and industrial purposes.

It is conservatively estimated that the gas plants of the country are capable under proper conditions during the year 1918 of producing 6,000,000 gallons of toluol.

In short, these public utilities, electric, gas, and transportation, must be relied upon absolutely to furnish (*a*) the increased demand for power, heat, and light; (*b*) at least 20 per cent of the toluol necessary for the prosecution of the war; (*c*) an important short-haul freight service to relieve the congested steam-railroad conditions at terminals and industrial centers, together with more transportation facilities for the new army of workers engaged in the new industrial centers being established by reason of war demands.

NEW CAPITAL REQUIREMENTS.

The electric railway, gas, and electric light and power companies up to the beginning of the war were spending between $600,000,000 and $700,000,000 in new construction. Shortly after the outbreak of the war a drastic policy of retrenchment was generally adopted.

They are now faced with the necessity of raising from $100,000,000 to $200,000,000 in new capital to furnish additional railway, gas and electric power and lighting facilities to shipyards, munition plants, cantonments, navy yards, and industry generally to meet the exigencies of the war program.

Certain typical cases are briefly referred to, viz:

"A" company, supplying electricity to several industrial centers located in New England, is required to construct additional electric power plants of 46,000 horsepower capacity, at an estimated expenditure of $5,500,000, to supply increased demand for electric power.

"B" company, supplying gas to a city in the Middle West where war contracts to the amount of several hundred millions of dollars have been awarded in connection with the Government's aviation program. The manufacturers concerned in these contracts are demanding of the local gas company an additional supply of from 4,000,000 to 5,000,000 cubic feet of gas daily. To meet this new demand the gas company will have to construct new gas works at an estimated cost of one and three-quarters millions of dollars.

"C" company, operating in the vicinity of newly constructed shipyards, which shipyards, with their increased demand for power, new housing facilities, and extensions to the transportation system, will require additional track mileage and street car facilities, an increased supply of gas, and a 40,000 horsepower increase in plant capacity. To satisfy these demands this company will need to expend upward of ten millions of dollars.

"D" company, in the Middle West, has recently brought into service some 35,000 horsepower of hydroelectric and steam-plant capacity, which plant capacity was needed as auxiliary and reserve capacity for the peace demands made upon the system for electric power and light. Increased demand for industrial power due to war orders from the War and Navy Departments and in furtherance of the aviation program has absorbed the entire additional capacity, leaving the company without reserve or auxiliary notwithstanding its recent expenditure for construction of $6,500,000.

PERILS OF THE SITUATION IN RE PUBLIC UTILITIES.

These companies must provide for term obligations maturing during 1918 approximately $225,000,000.

These companies must also pay or extend bills payable in the form of corporate unsecured paper held by banks of approximately $250,000,000.

Operating companies, being unable generally to finance their requirements on account of the infrequent turn of their capital, have been supported by holding companies, which holding companies have furnished funds to subsidiaries, which funds were obtained through the issuing of various short-term notes, many of which appear in the list of maturing obligations for the year 1918.

It is strictly true that operating companies will be entirely unable to liquidate their bills payable, either to the banks or to the holding companies, in the year 1918. It is strictly true that the holding companies will be unable to liquidate their obligations maturing in the year 1918, and they must be extended or refunded.

Such moneys as were raised during the latter part of 1917 were obtained at a constantly increasing rate of interest, and money cost the corporate borrower before January 1, 1918, 8½ per cent or more.

Many solvent companies have in hand duly authorized corporate securities sufficient, if sold at any reasonable price, to provide money for their maturing obligations, but there is now no market for public-utility securities and no immediate prospect of any market for them.

The public press has recently printed reports that certain large public-utility companies have been placed in the hands of receivers. Among others, the Bay State Street Railways of Massachusetts, the United Railways of St. Louis, and the Pittsburg Railways Co. have been mentioned. Attention has been called to the reorganization plan of the San Francisco railways, which plan provided for the sale of a large amount of new securities to take care of 1918 maturities.

The four companies mentioned above have outstanding stocks and bonds aggregating $250,000,000, and the mileage operated totals 2,325 miles.

The outstanding securities of street railway companies placed in the hands of receivers during 1917 exceeded $67,000,000, the largest in many years.

A short list of companies whose subsidiaries operate in hundreds of communities has been tabulated, and these few companies have tens of millions of obligations maturing before July, 1918.

We append a short list of operating companies having sizable maturities in the first half of 1918:

Feb.	Alabama Power Co. (3 yr. 6's)	$2,000,000
	Toledo Traction, Light & Power Co. (5 yr. 6's)	8,213,000
Mar.	Eastern Power & Light Co. (5 yr. 6's)	2,350,000
Apr.	Louisville Gas & Electric Co. (3½ yr. 6's)	1,500,000
	Massachusetts Electric Co. (3 yr. 5's)	3,200,000
	United States Public Service Corporation (coll. 6's)	1,200,000
	Wilmington & Chester Co. (coll. 5's)	2,305,000
	Omnibus Cable Co. (first 6's)	2,000,000
May.	Detroit United Railways (coll. 5's)	3,250,000
June.	Tennessee Railway, Light & Power Co	3,250,000
	New Orleans Railway & Light Co	3,250,000
	United Railway Co. of St. Louis	3,250,000
July.	Brooklyn Rapid Transit Co. (6 yr. 5's)	57,735,000
	Kansas City Railroad (3 yr. 5½'s)	7,922,000
	Louisville Gas & Electric Co. (first and R 6's)	9,000,000
	Providence Gas Co. (3 yr. 4's)	1,400,000

The great danger is that a few companies will fail almost immediately. Their failure would throw suspicion on absolutely solvent companies and perhaps bring about a complete collapse.

Monthly maturities are:

January	$7,250,000
February	12,950,000
March	4,700,000
April	12,156,000
May	23,540,000
June	11,290,000
July	80,092,000
Total	151,978,000

In the list are many serious situations, and the matter is so delicate that it seems impossible to mention names. Unless assitance is afforded, and that almost immediately, certain of these companies whose maturities are shown in the above list will be obliged to go by the board.

We must advise that there can be no speeding up of the nation's industries, and no maximum effort in the war program can be had if the needs of these public utilities are not taken care of. To the contrary, there will be a startling falling off in the production of war materials because of failure of supply of power, gas, and transportation by those best equipped and best able to furnish these services and extend them as required if in some way their immediate financial requirements can be provided for.

Since the 1st of January, the Bay State Street Railway Co., of Massachusetts, and the United Railways Co., of St. Louis, have been placed in the hands of receivers; the Pittsburgh Railways Co. has defaulted on its interest, and the reorganization plan of the United Railroads of San Francisco has had to be practically indefinitely postponed.

The following is a statement with reference to the mileage and capitalization of these companies:

	Capital stock.
Bay State Street Railway Co. of Massachusetts (991.37 miles):	
Common	$20,517,200
First preferred	3,748,600
New preferred	737,700
Bonded debt	24,156,000
United Railways Co. of St. Louis (458.73 miles):	
Common	24,913,800
Preferred	16,383,200
Bonded debt	55,962,000
Pittsburgh Railways Co. (603.89 miles):	
Common	2,500,000
Preferred	2,500,000
Bonded debt	8,275,000
Income debentures	10,000,000
United Railroads of San Francisco (271.78 miles):	
New securities to be issued and exchanged under reorganization plan—	
6 per cent gold bonds	25,764,000
First preferred stock	1,958,000
Second preferred stock	6,000,000
Common stock	14,000,000

The capitalization of the four companies mentioned above aggregates $217,000,000.

PUBLIC UTILITY FINANCING.

The funded obligations of public utilities maturing in 1918 amount to approximately $225,000,000.

The money required by public utilities for unavoidable extensions during the year 1918 is variously estimated between $100,000,000 and $200,000,000. These estimates are based on the assumption that no extensions will be made or allowed to be financed unless directly or indirectly essential to the vigorous prosecution of the war.

It therefore seems clear that the unavoidable capital requirements of public utilities in the year 1918 will be between $325,000,000 and $425,000,000. This is exclusive of banking accommodations amounting to approximately $250,000,000, which it is assumed the banks will continue to furnish if these capital requirements are provided for.

It is obvious that these capital requirements can not be financed without assistance from the Government, and it is assumed that in order to prevent financial disaster the Government will make some arrangement for such assistance.

Assuming that the Government is to have a fund available for this purpose and some tribunal charged with its administration, it is important to determine on what basis and under what conditions the fund should be made available.

So far as public utilities are concerned, it is essential that the fund be made available for the weaker companies as well as the stronger ones, some of which, on their own credit, might even under, existing conditions, take care

of their own financing. In other words, it might be necessary to extend aid in some cases where, under a strict application of banking standards, credit would not be extended.

Under this liberal plan there would obviously be more ultimate losses than under a plan limiting relief only to the strongest concerns. Accordingly the Government should be guaranteed against any loss. This could be done by establishing a guaranty fund, and such a fund could be established by one of several methods.

1. If legally feasible, levy a tax upon all public utilities based upon gross earnings (a tax of one-half of 1 per cent would produce $8,000,000 annually). Any company availing itself of Government credit might, in addition to the tax upon its gross income (which should be imposed upon all public utilities whether or not they avail themselves of Government credit), be compelled to pay a further tax based on the amount of aid extended, such additional tax to be embodied in the rate of interest charged and to be turned into a common guaranty fund. In other words, if the Government were paying 4½ per cent for its money, it might charge the utility—say, 6 per cent; the extra 1½ per cent being used as an accretion to the guaranty fund.

The tax on gross earnings should continue indefinitely until such time as the United States Government should decide that the guaranty fund was sufficient, when the annual tax on gross earnings should cease. When all liability on the part of every company has been satisfactorily provided for, then any amount remaining in the guaranty fund should be returned to the contributing companies in the proportion contributed by them.

In case plan No. 1 should be considered impractical by reason of any question as to the power of Congress to levy a tax on all the utilities for the purpose of establishing a guaranty fund, the same result could be accomplished in another way, as follows:

2. Let the law imposing the tax for the creation of the guaranty fund specify that the tax shall be applicable only to such utilities as prior to a specific date file with the proper authorities an indication of their acceptance of the act. Let it further provide that only such companies as accept the provisions of the act as specified shall be qualified as applicants to file a request for financial relief.

It is believed that the practical result of such a provision would be that substantially all companies would accept the provisions of the act. No one can now say how long the war conditions will last, and no company can now be certain that it will not be called upon for a part in the war program which will require additions to its present equipment, and few companies would be so shortsighted as to put themselves beyond the possibility of necessary financial assistance simply to relieve themselves of a relatively small tax.

3. Instead of levying a tax on all public utilities, it might seem wise to levy the tax only upon such companies as applied for relief.

NOTE.—Approximately 75 per cent of the public utilities of the country are owned in whole or in part by so-called holding companies which are responsible for financing the operating companies. This financing is done through the securities of the parent company, which securities are supported by the securities of the various operating companies. This gives a strength to the securities of the parent company which a single localized operating company could not present. If it were not for the supporting strength of these parent companies many of the individual operating companies would have gone under before January 1, 1918. It is essential that any arrangement for assisting the general public-utility financing should be broad enough to include within its provisions these parent companies. If the Government financial aid is extended through the parent companies wherever possible the process will be very much simplified and the demands upon the guaranty fund on the part of the Government reduced to a relatively nominal amount.

The objection might be raised to the suggested establishment of a guaranty fund that the stronger companies would be unwilling to contribute to such fund, the obvious purpose of which is to protect the Government against losses by reason of advances to the weaker companies. It is confidently submitted, however, that the great proportion of the stronger companies will be entirely willing to do their part to protect the general situation by cooperating in some plan along the lines indicated. This committee has consulted with representatives of as many companies as was possible in the time at its disposal, and the plan suggested has met with their hearty approval.

Mr. GADSDEN. Our study of the situation brought us to this conclusion, that there were four phases of the public-utility situation in this country which required immediate action, and each had an important bearing upon the other; that you could not consider one phase without taking into consideration the other elements entering into the public-utility situation. Those four phases were, first, the question of rates; second, the matter of the demands being made upon public utilities by municipalities and by public-service commissions for what in war times are unnecessary capital investments, such as repaving of streets, the undergrounding of wires, the enlargement of gas mains, where existing mains would do. The third was the very heavy demand being made upon the industry to speed up the whole war program; and the fourth, and the vital one—vital to ourselves and to our country, as I think I can show you—was the question of maturities. We have maturing in 1918 about $225,000,000 to $235,000,000 of securities which must be met, maturing by the month. I will ask you to allow me just briefly to run over those points so as to give you a picture of how this thing looked to us.

The public utilities, as you know, by law, are the only class of industry in the United States to-day which are being required to sell their services and their facilities on a prewar price, notwithstanding the fact that they are being eaten alive by the extraordinary increases in cost of material and labor. The Government itself has fixed the price of copper at 23 or 24 cents, whereas we bought it at 11 cents when the war broke out. The Government has fixed the price of coal at about a hundred per cent more than our rates were based on. You know what the labor situation is. The Government is competing for all the labor in the country. We are trying our best to keep our men at an increased cost for labor. So that the public utilities are in this anomalous situation, that we are required by law to perform a public service, our facilities and our services are impressed with a public trust, and we can not stop if we want to.

Senator GORE. And you can not go on.

Mr. GADSDEN. And we are selling our service to-day at less than it costs to produce it throughout this country. Of course, we are making application to the various public-service commissions and city councils for relief. We are getting relief in spots here and there, but we find that the public-service commissions, like everybody else, sympathize with the proposition and they say it is unjust, but they do not feel that the great public behind them would support them in an increase.

Senator LODGE. The great public wants something for nothing.

Mr. GADSDEN. Sure, and the great public are forcing us to do that very thing. We are making a contribution of millions of dollars out of our earnings to-day because we are selling service at less than it costs us to produce it, and therefore an involuntary tax is being exacted of us for the benefit of the country.

If there were one special body in Washington before whom we could go we could have this thing remedied, we hope; but unfortunately this is a local question. One of our efforts down here has been endeavoring to work out some plan by which the national conscience of America could be aroused to the injustice which is being done to the public utilities, so that when we went before our local

community it would be considered from a national standpoint. If the application was made in Boston it would not be looked upon as a Boston proposition, but as a part of the necessary burden of the war. If I go to my city council, and I am going before them to-morrow in Charleston, S. C., they think the little gas company in Charleston has no connection with the war, and they say that Savannah has not granted an increase yet, and Wilmington has not granted an increase and therefore they are not going to. I know you gentlemen can not give us any relief on that, but what I am leading up to is this:

Senator GORE. Why do you say that we can not give you any relief?

Mr. GADSDEN. I wish you could, but I do not believe you could.

The CHAIRMAN. You state that you could not get any relief from the Federal Government?

Mr. GADSDEN. There ought to be something in this war emergency to relieve the situation, but what we do believe is that the President as Commander in Chief might do it.

Senator GORE. Under the war power Congress could do it.

Mr. GADSDEN. And we are trying to bring it to his attention, because the thing ought to be handled as a collective proposition. Now, the bearing which it has upon this hearing is that that process is sapping the very life out of the values of these properties. It has eaten up the equity, and when we come to the question of borrowing money from banks our values have been destroyed. Now, I am coming to section D, Senator Smoot.

The CHAIRMAN. To what extent, as a rule, have your securities depreciated?

Mr. GADSDEN. I have a statement here similar to the one Mr. Bertron referred to. We took 17 leading public utility companies whose stocks were listed on the stock exchange, the common stock, and it showed from the high point within the last five years to the present low level a depreciation of $352,000,000, or 53 per cent in our securities. That was common stock.

Senator SMOOT. That represented a good deal of water?

Mr. GADSDEN. I do not think you are right about that, Senator.

Senator LODGE. I do not know about other States, but in the public utility corporations of Massachusetts there is no water whatever. On the contrary, they have issued new stock at the market rate.

The CHAIRMAN. I was not speaking about your stocks; I was speaking about your bonds.

Mr. GADSDEN. I only stated that as an indication of the general trend. The bonds have gone way down.

The CHAIRMAN. The bonds have gone down. And then I understand you to say, on the other hand, that your service has expanded but your profits are not as great as they were before because, while your service has increased, your rates have been held fixed.

Mr. GADSDEN. The margin between the cost of operation and the gross receipts has greatly diminished until in some properties it has disappeared.

The CHAIRMAN. And for that reason your securities have fallen and you are having difficulties.

Mr. GADSDEN. Very great difficulty.

Senator GORE. That involves not only public-service corporations but industrials, as well, excepting the special war industries?

Mr. GADSDEN. Not a bit, because they are able to pass the burden on to the consumer. The cotton mills of the South are buying cotton at 25 to 30 cents a pound, and they never were more prosperous in their life.

Senator LODGE. They are not confined by rates.

Senator GORE. I mean the general trend you speak of involves a reduction in industrial securities, as well as public-utility and public-service corporations.

Mr. GADSDEN. Undoubtedly the general trend of securities.

Senator GORE. And that is due to the fact that the rate of interest has gone up?

Mr. GADSDEN. Undoubtedly.

Senator GORE. And that is intensified in the case of public utilities.

Mr. GADSDEN. But the point I am leading up to, so far as public-utility corporations are concerned, is that we are one class of industry which I think I can show you is absolutely essential to the war.

Senator SMOOT. There is no question about that.

Mr. GADSDEN. The entire speeding up of the war program must come from the electric power furnished by our plants. Hundreds of thousands of these operatives, day and afternoon and night, must be carried, and we must carry them, and the power must come from our gas and electric plants. In that situation we are faced with this condition: The Government requires us to expend from one hundred million to two hundred million dollars for the Government's needs. They are requiring distributing lines to be extended, gas plants to be built, and electric plants to be enlarged, and we do not know where we are going to get this money. That money has got to be furnished by somebody to the public utilities if this war program is carried out. We understand that that is one of the cases to be covered by section D. That certainly is one of the exceptional cases.

Senator SMOOT. You do not expect the Government of the United States to take the common stock?

Mr. GADSDEN. No, sir.

Senator SMOOT. Has any one of these 17 companies failed to make their interest on their bonds?

Mr. GADSDEN. Not yet.

Senator SMOOT. Has any of them failed to make the interest on the preferred stock?

Mr. GADSDEN. A good many of them have passed their preferred. I have not checked up those 17 yet.

Senator SMOOT. That, of course, would be the security that you have to offer if you went to the banks for your loans, and I do not think the Government of the United States would go to work and advance money under paragraph D of section 6 of this bill based on common stock.

Mr. GADSDEN. I do not, either. Nobody ever asked that.

The CHAIRMAN. Common stock is not a security at all.

Mr. GADSDEN. I only stated that as an illustration of the trend of conditions. What we do want this committee to consider seriously is that there will mature this year our high-grade bonds, first-

mortgage bonds, put out years ago with ample equity behind them, 225,000,000 of them. We say we can not get that money from banking concerns. There is a gentleman in this room right now who has $800,000 of maturities on the 1st of March. He is utterly unable up to date to get the present holders of it to extend him even 30 days. Why? Because the equities of those properties have been eaten up or are being eaten up under this very process I am telling you about, of requiring us to perform our services at a loss.

Senator SMOOT. Are those first-mortgage bonds?

Mr. GADSDEN. First-mortgage bonds. The banker says, "Your bond was all right when you put it out; give us your cost of labor and material and your gross receipts; give us your receipts for the last three months."

Senator SMOOT. Do you have to include that to get them to advance the money, when the bankers of this country believe the equities are being eaten up?

Mr. GADSDEN. I think so. I am going to tell you why.

Senator TOWNSEND. What would you do in a case of that kind?

Mr. GADSDEN. Suppose you have 225,000,000 of securities going by the board in this country.

Senator GALLINGER. Does that cover the electric companies and the gas companies?

Mr. GADSDEN. Electric, gas, and railway. That would destroy your whole financial fabric. That is the justification for it.

Senator GORE. Are renewals your chief difficulty?

Mr. GADSDEN. Renewals. We take it that the Government is going to find this extra $200,000,000 if they want us to extend.

Senator GORE. If you were enabled to meet your renewals, do you think you would be able to weather the storm?

Mr. GADSDEN. I do. We believe this renewal proposition, gentlemen, is something which is right up to the Government.

Senator GORE. To what extent do you charge your difficulties to the rate situation?

Mr. GADSDEN. To this extent: That it has affected our credit to such a point that temporarily our securities are not attractive to the ordinary banker, because we can not show the margin of safety of net earnings over and above the earnings on interest and bonds which we used to show.

Senator GORE. If you could get a satisfactory increase in rates, that would enable you to get along without governmental aid?

Mr. GADSDEN. Undoubtedly; but where are you going to get them?

Senator JONES. Your securities are sound; they have the value behind them. What about the rate of interest? Can you hope to renew those securities at the same rate of interest?

Mr. GADSDEN. Through ordinary banking agencies?

Senator JONES. Yes.

Mr. GADSDEN. No. Mr. Bertron referred to the case of one of the strongest public utilities in this country, which paid 13½ per cent for $10,000,000 for two years, the other day.

Senator JONES. Then what rate of interest would you expect this institution to give those securities?

Mr. GADSDEN. Whatever was fair; whatever they fixed we would have to pay.

Senator GERRY. Is it your theory that if the Government financed you it would aid you in obtaining higher rates?

Mr. GADSDEN. Our idea is that it would have a good, wholesome effect. We could go back to the public-service commissions and say Congress has recognized the justice and equity of our situation and that then it was up to them to give us a rate which would put back life into these properties.

Senator TOWNSEND. Is it not also a fact that one of your objects is to get that for temporary relief; that you have the value, and if you can be tided over this point you may save valuable property, and be of service to the Government?

Mr. GADSDEN. Exactly.

Senator TOWNSEND. If the local authorities would grant an increase in rates, that would relieve your situation and greatly diminish the Federal Government's difficulties?

Mr. GADSDEN. It would largely diminish this problem which somebody has got to meet. We have thought of trying to get the President to issue some public statement so as to simply concentrate the national thought on the problem.

Senator GORE. Have you considered a moratorium at all?

Mr. GADSDEN. Yes, Senator, we have.

Senator GORE. Of course that would help some?

Mr. GADSDEN. We feel that would be disastrous.

Senator GORE. It would relieve the credit situation.

Mr. GADSDEN. There is not one of our committee but would feel that would be the beginning of the end, to single out the public utilities and declare a moratorium, which would still further depreciate the value of our credits.

Senator GALLINGER. That simply delays the evil day.

Mr. GADSDEN. It would simply mark us out in the market as having a lot of securities worse than anybody else's.

Senator GALLINGER. If the Government were to let you have the money at a low rate of interest, would not the communities in which you have your properties be rather inclined or induced to insist that the rates should remain where they are because you are getting cheap money from the Government?

Senator LODGE. Absolutely.

Mr. GADSDEN. We are not asking the Government to give us any cheap money. We are asking the Government to take this situation and handle it on whatever is a proper basis. To show this committee how we feel about it, we applied to the Treasury Department; we suggested, for instance, as to this corporation that is being considered, that a provision could be inserted in the bill to the effect that all public-utilities companies shall have 30 days after the passage of this act, or 60 days, to signify their willingness and intention to come in under this act and qualify themselves as applicants for relief, on condition that they would agree to contribute to the Treasury of that corporation one-half of 1 per cent of their gross receipts, as a guaranty fund against loss. One-half of 1 per cent would create a fund of eight millions. We went far enough to sound out the big utilities companies who would not come for relief, and everyone agreed they would be willing to do it.

Senator THOMAS. Can you give an estimate of the amount of money that would be necessary to relieve the situation?

Mr. GADSDEN. There are $225,000,000 of securities which mature this year.

Senator THOMAS. Is it your idea that the relief you need would be covered by that amount of money?

Mr. GADSDEN. Largely, I think so.

Senator THOMAS. How much more would be required?

Mr. GADSDEN. We have nothing further to come to the Government for. We have got to fight for our own salvation as to rates.

Senator GORE. That would save your life?

Mr. GADSDEN. It would save our life.

Senator THOMAS. What you want is that the Government should tide you over this emergency that now confronts you because of the maturity of your securities?

Mr. GADSDEN. That is the point.

The CHAIRMAN. What you are really asking the Government to do is to make a loan upon your securities, without reference to what the market values of the securities now are, and then you are proposing to set apart a part of your earnings to make up that difference?

Mr. GADSDEN. We propose it now to this committee. You will find a plan quite extensively worked out in this brief of mine. We propose to create a guaranty fund, and we consulted some of the big companies, who would not in the ordinary course of events need to ask aid. One of them, for instance, that I am associated with has not any maturities, and they said they would be very glad to cooperate for the general good.

Senator GORE. A community-of-interest fund?

Mr. GADSDEN. It could be made entirely legal by making it a voluntary contribution, and thus they would qualify themselves for relief if they should need it.

Senator WILLIAMS. One-half of 1 per cent of the gross receipts?

Mr. GADSDEN. Yes. Our gross receipts are about $1,600,000,000 a year.

Senator GORE. Is that of the three different lines?

Mr. GADSDEN. Yes; of the entire industry.

The CHAIRMAN. That would make it necessary for you to come in under the exceptional case clause of the act?

Mr. GADSDEN. We suggest that instead of the words "exceptional cases" you insert "public utilities."

Senator WILLIAMS. All public utilities are not lying in the same bed, are they?

Mr. GADSDEN. They are all operating under rates fixed by law, and the same principle applies to all.

Senator WILLIAMS. Some of the companies are still prosperous, making large net profits?

Mr. GADSDEN. I think very few.

Senator GORE. Have you estimated what general increase in rates would be necessary, on the average?

Mr. GADSDEN. No; we have not.

Senator WILLIAMS. I think those in Washington are doing very well.

The CHAIRMAN. How is that? Have you investigated? Senator Williams says the public utilities, especially the street cars, in Washington are doing mighty well.

Mr. GADSDEN. I do not know about Washington, but I am operating a street car line in Charleston which has exactly the same conditions. We have a navy yard at one end of the line, whose employees have increased from 1,500 to 4,000 during the war. It is impossible to deliver them all at a given time at the end of that line. It is impossible to get enough motormen and conductors to run the cars, because a man can step off the car and walk into the navy yard and get three times what we can possibly afford to pay him.

Senator SMOOT. Are you not making as much money as you did before?

Mr. GADSDEN. No, sir. We are not making any money at all. You gentlemen have not any conception of the conditions.

Senator SMOOT. That is not the case in Washington.

Mr. GADSDEN. I rather think you will find it so if you should go into the matter. The cost of material for repairing these cars, everything that goes into them, has gone up anywhere from 50 to 200 per cent. We have had to increase the wages of our men at least once a year for the last two years, and they still are not getting enough to live on and they are still leaving us; and the great burden of complaint, in Washington and elsewhere, of the railways of this country is as to their service, and that comes from want of men. I want to say that if this war keeps up long enough the time will come when, if your street railways are to be operated, you must furnish us enlisted men to do it. Why should the men work for a street car company for $3 a day when they can go to the shipyards and get $9? I went to the commandant of the Charleston yard six months ago and said, "Why not detail 40 or 50 of your enlisted men; I will pay them the same rates, and let them run the cars up and down?" Certainly, it is as important a duty as to guard a water main.

Senator SMOOT. Under the law they would have no right to do it.

Senator GORE. Did you give the gross earnings for the calendar year?

Mr. GADSDEN. For the calendar year.

Senator GORE. What were the gross earnings in these concerns in 1913?

Mr. GADSDEN. I do not think I can furnish them for that year. We have the table giving the gross earnings for 1914, 1915, 1916, and 1917, and the net. We have the gross earnings from operation for the last six months of 1916 and 1917 and for the last three months of 1916 and 1917. Comparing the results for the years 1916 and 1917, there is a marked increase in operating expenses and operating ratio in 1917 over 1916, and the situation becomes worse in the latter part of 1917, with every indication of a worse showing in 1918. I had a coal contract for $1.10 at the mine renewed at $3.12. Of course, the high prices of material, etc., increased greatly at the end of 1917.

Senator GALLINGER. How about oil?

Mr. GADSDEN. That has gone up 200 or 300 per cent; at least 200 per cent.

Senator GORE. The oil men claim they are the only ones who have not raised their prices.

Mr. GADSDEN. The price of oil that gas companies use has gone up from 3½ cents a gallon to 7 and 8 cents, and we have paid as much as 9, 10, and 11 cents, by the trainload, to protect Philadelphia.

Senator GORE. Are those figures in the document you are going to print?

Mr. GADSDEN. No; we have not that in the statement.

Senator GORE. I mean your statement as to the gross earnings?

Mr. GADSDEN. Yes, sir; that is in the table here.

The CHAIRMAN. Is there anything further?

Senator SMOOT. Mr. Gadsden handed me a copy of a statement showing the public-utility securities maturing during 1918, which I would like to have go in the record.

The CHAIRMAN. Let them go in.

(The statement referred to by Senator Smoot is here printed in full, as follows:)

Public-utilities securities maturing during 1918 (other than equipment-trust obligations.)

JANUARY.

Benton Harbor-St. Joseph Gas & Fuel Co., first sixes	$100,000
California Street Cable R. R., general first serial refunding sixes	26,000
Citizens' Water & Light Co., Winchester, Ind., first fives	3,000
City Water Co. of East St. Louis and Granite City, Ill., consolidated sixes	1,135,000
Cleveland & Buffalo Transit Co., first fives	35,000
Columbia Telephone Co., first fives	27,000
Consolidated Natural Gas Co., Bradford, Pa., first sixes	55,300
Cumberland Telephone & Telegraph Co. (Inc.), first fives	686,000
Danville Street Railway & Light Co., refunding fives	6,000
Danville, Urbana & Champaign Ry., second sixes	50,000
Gettysburg Gas Co., first fours	15,000
Holton Interurban Ry., first sixes	5,000
Holton Power Co., first sixes	25,000
Hughes Electric Co., first sixes	10,000
Kansas Natural Gas Co., sinking-fund second sixes	1,700,250
Lorain Street R. R., 3-year collateral-trust 6 per cent notes	200,000
Milford, Holliston & Framingham Street Ry. first fives (Milford & Uxbridge Street Ry.)	165,000
Milford & Uxbridge Street Ry., first fives	335,000
Northern New York Power Corporation, first serial sixes	20,000
Ohio Cities Gas Co., 6 per cent serial notes	625,000
Otter Tail Power Co., first sixes	60,000
Plymouth Electric Light Co., first fives	2,000
Portsmouth & Suffolk Water Co., first sixes	9,500
Princeton Water Co., first fives	2,000
Trenton (Mo.) Gas Light & Power Co., first sixes	50,000
United Light & Railways Co., 6 per cent coupon notes	750,000
Wagner Gas Co., 6 per cent bonds	2,500
Warren & Jamestown Street Ry., second fives	100,000
Keokuk Gas Light & Coke Co. (Keokuk Electric Co.), first fives	150,000
Pacific Light & Power Corporation, general-mortgage serial-convertible sixes	900,000
Western Natural Gas Co., first sixes	10,000

FEBRUARY.

Alabama Power Co., first mortgage 3-year sixes	2,000,000
American Telephone & Telegraph Co., 4½ per cent 2-year notes	50,000,000
Brocton & East Bridgewater Street Railway (Bay State) first fives	30,000
Central Maine Power Co., 3-year 6 per cent notes	600,000
Detroit Gas. Co., consolidated gold fives	375,000
Gloucester Electric Co., first fives	48,000

Great Northern Power Co., 3-year 6 per cent collateral trust notes	$650,000
Houghton County Gas & Coke Co., first fives	4,000
International Traction Co., series 6 per cent debenture notes	50,000
Iowa Telephone Co., 2-year 4½ per cent notes	3,000,000
Kansas City Pipe Line Co. (Kansas Natural Gas Co.), first sixes	350,000
Kennebec Light & Heat Co. (Central Maine Power Co.), first fives	104,500
Lake Charles Ry., Light & Water Works Co., first sixes	15,000
Laredo Water Co., first sixes	24,000
Michigan Power Co., first serial fives	75,000
Missouri & Kansas Telephone Co., 4½ per cent notes	8,000,000
Nebraska Telephone Co., 4½ per cent 2-year notes	4,000,000
Northern Virginia Power Co., coupon sixes	3,000
Northwestern Telephone Exchange Co., 4½ per cent 2-year notes	10,000,000
Oakland, Antioch & Eastern Ry., 6 per cent convertible notes	317,500
Oklahoma, Kansas & Missouri Interurban Ry., first sixes	10,000
Peoria Ry., first fives	90,000
Philadelphia Co., 6 per cent collateral notes	250,000
Southwestern Telegraph & Telephone Co., 4½ per cent 2-year notes	5,000,000
Toledo, Traction, Light & Power Co., first lien 5-year sixes	7,013,000
Toledo, Traction, Light & Power Co., second lien collateral trust sixes	1,200,000
Webb City & Carterville Gas Co., first sixes	5,000
Western United Gas & Electric Co., first and refunding fives	25,000
Western United Gas & Electric Co., general sixes	90,000
Consolidated Electric Light Co. of Maine, debenture sixes (Cumberland Co. Power & Light Co.)	10,000

MARCH.

Aurora, Elgin & Chicago R. R. 3-year 6 per cent collateral trust notes	800,000
Chikasha Gas &Electric Co., first serial sixes	15,000
Coshocton Light & Heating Co., serial sixes	4,000
Danbury & Bethel Street Ry., debenture sixes	63,000
Eastern Power & Light Corporation 5-year convertible fives	2,350,000
Iowa Gas Co., first serial sixes	1,000
Johnstown Water Co., 4 per cent bonds	210,000
Lewiston, Brunswick & Bath Street Ry., first fives	845,000
Long Branch Water Supply Co., first five-and-a-halfs (Tintern Manor Water Co.)	100,000
Mahoning Valley Water Co., first sixes	14,000
Oklahoma Natural Gas Co., first sixes	200,000
Palatka Water Works, first sixes	73,500
Turners Falls Power & Electric Co., first 5-year 5 per cent notes	250,000
Urbana Light, Heat & Power Co., first consolidated fives	2,000
Connecticut Co., 4½ per cent gold equipment notes, series B	46,000

APRIL.

Catskill Illuminating & Power Co., debenture sixes	12,000
Central Home Telephone & Telegraph Co., first-mortgage and collateral trust 6 per cent notes	350,000
Cincinnati & Hamilton Electric Street Ry., first sixes	400,000
Como Light & Power Co., first sixes	5,000
Evansville Railways Co., 5-year 6 per cent secured notes	52,900
Franklin Water, Light & Power Co., first fives	3,000
Gas Light Co. of Augusta, Ga., first serial fives	10,000
International Traction Co., serial 6 per cent secured notes	100,000
Lansing Gas Light Co., first sixes	100,000
Louisville Gas & Electric Co., 3½-year 6 per cent notes	1,500,000
Mansfield Railway, Light & Power Co., general gold fives	742,000
Massachusetts Electric Co., 3-year 5 per cent notes	8,000,000
New Jersey Power & Light Co., 6 per cent guaranteed notes	50,000
Nyack Gas Light & Fuel Co., first fives	45,000
Ocean Electric Ry., first fives	20,000
Ravenna Gas & Electric Light Co., first sixes	1,000
Stone & Webster, 3-year 6 per cent notes	150,000

Union Natural Gas Corporation, collateral trust 6 per cent, series A to L	$500,000
United States Public Service Co., 6 per cent collateral lien notes	1,200,000
Wilmington & Chester Traction Co., collateral trust fives	2,305,000
Omnibus Cable Co. (United R. R. of San Francisco), first sixes	2,000,000
Dedham & Hyde Park Gas & Electric Light Co., first fives	60,000
Southern Penn Telephone & Telegraph Co., first serial sixes	1,000
Joliet R. R., general gold fives	400,000

MAY.

Charleston Interurban R. R., 3-year 6 per cent collateral trust notes	450,000
Commonwealth Power, Railway & Light Co., 5-year convertible sixes	10,000,000
Empire Electric Power & Supply Co., first fives	4,500
Florida Power Co., first serial sixes	10,000
Fort Smith Light & Traction Co., debenture sixes	300,000
Freeport Ry., Light & Power Co., first fives	5,000
Grand Forks Street Ry., first sixes	50,000
Great Bend Water & Light Co., serial fives	1,000
Hammond Illuminating Co. (Northern Indiana Gas & Elec. Co.), consolidated fives	24,000
Iowa City Gas & Electric Co. (Iowa City Light & Power Co.), first sixes	4,000
Lansing Gas Light Co., consolidated sixes	100,000
Little Falls Water Power Co., first fives	5,000
Metropolitan Telephone & Telegraph Co. (New York Telephone Co.) first fives	1,501,000
Minnesota Electric Light & Power Co., first serial sixes	3,000
Missouri Valley Light & Power Co., first mortgage 6 per cent notes	13,000
Norfolk County Water Co., 3-year collateral trust 6 per cent notes	275,000
Northern Ohio Traction & Light Co., collateral trust sixes, first issue	100,000
Potter Gas Co., first refunding sixes	1,000,000
Quapaw Gas Co., first serial sixes	100,000
Seattle, Renton & Southern Ry., first fives	60,000
Suffolk Gas & Electric Light Co., first fives	200,000
Sutter Street Ry. (United Railways & San Francisco), first fives	1,000,000
Texas Gas Co., first serial sixes	50,000
Union Light, Heat & Power Co., first fours	1,561,700
Urbana Light, Heat & Power Co., first fives	2,500
Warren Street Ry., third sixes	100,000
Detroit United Ry., 5 per cent collateral trust-coupons notes	3,500,000
Cleveland Telephone Co., 2-year 5 per cent notes	3,000,000
Decatur Gas & Electric Co., first fives	15,000
Tuscarawas County Electric Light & Power Co., first sixes	3,000

JUNE.

Albia Interurban Ry. (Southern Iowa Ry. & Light Co.), serial sixes	7,000
Butte Electric & Power Co. (Montana Power Co.), first fives	25,000
Central Electric Ry. (Pacific Gas & Electric Co.), first sixes	25,000
Coffeyville Gas & Fuel Co., first sixes	15,000
Edison Electric Illuminating Co., of New Brunswick, first sixes	50,000
Lewiston, Augusta & Waterville Street Ry., 3-year 5 per cent notes, series C	614,000
Manchester Traction, Light & Power Co., 3-year 5 per cent coupon notes	1,000,000
Maple Leaf Telephone Co. (Tri-State Telegraph & Telephone Co.), 6 per cent bonds	23,000
Newburgh Light, Heat & Power Co., convertible debenture eights	300,000
New Orleans Ry. & Light Co., 2-year 6 per cent debenture notes	3,250,000
Ohio Gas Light & Coke Co., first serial sixes	5,000

Tennessee Ry., Light & Power Co., 2-year 5 per cent secured notes	$2,500,000
Union Depot R. R. (United Rys. Co., of St. Louis), consolidated sixes	3,500,000

JULY.

Alum Rock Gas Co., first sixes	15,000
Bakersfield Water Co., first serial sixes	5,000
Bristol-Goodson Water Co., first gold fives	32,000
Brooklyn Rapid Transit Co., 6-year 5 per cent gold notes	57,735,000
Corona City Water Co., first sixes	5,000
Coshockton Light & Heating Co., first serial sixes	4,000
Detroit City Gas Co., general fives	100,000
Fort Scott & Nevada Light, Heat, Water & Power Co., first serial sixes	25,000
Freeport Water Co., first serial fives	5,000
Grinnell Electric & Heating Co., first fives	2,500
Hornellsville Electric Ry. (Hornell Traction Co.), first fours	70,000
International Transit Co., first serial fives	20,000
Kansas City Railway Co., 3-year 5½ per cent notes	7,922,000
Louisville Gas & Electric Co., first and refunding sixes	9,000,000
Martinsville Gas & Electric Co., first sixes	1,500
Michoacan Power Co., first sixes	60,000
New Telephone Co. (Indianapolis Telephone Co.), first and consolidated fives	456,000
Norfolk Central Street Ry. (Bay State Street Ry.), first fives	27,500
Northern Ohio Traction & Light Co., collateral trust sixes, second issue	100,000
Ohio Cities Gas Co., 6 per cent serial notes	625,000
Oklahoma Railway Co., junior mortgage sixes	15,000
Oklahoma Ry. Co., junior mortgage 6 per cent notes	500,000
Portsmouth Street R. R. & Light Co., first sixes	25,000
Providence Gas Co. 3-year 4 per cent convertible debentures	1,400,000
Reading Transit Co. (Reading Transit & Light Co.), series A, fives	7,500
St. Paul Gas Light Co. consolidated extended sixes	600,000
Salmon River Power & Light Co. first sixes	3,000
Shreveport Railways Co. first serial fives	10,000
Spokane Traction Co. (Spokane & Inland Empire Railroad) first fives	15,000
Sumpter Light & Water Co. (Northwestern Light & Water Co.) first fives	10,000
Sweetwater Water Co. first fives	2,000
Tilbury Town Gas Co. (Ltd.) first sixes	4,000
Triple State Natural Gas & Oil Co. (United Fuel Gas Co.) consolidated sixes	8,000
Twin City Telephone Co. (Tri-State Telephone & Telegraph Co.) first fives	35,000
United Railroads of San Francisco 6 per cent trustees' certificates	30,000
Wagoner Gas Co. (Caney River Gas Co.) 6 per cent bonds	2,500
Whittier Water Co. first serial sixes	7,500
Wilkes-Barre & Suburban Street Railway 4 per cent bonds	40,000
Oakland Transit Co. (San Francisco-Oakland Terminal Co.) first consolidated sixes	1,121,000
Menominee & Marinette Light & Traction Co. second (now first) fives	5,000

AUGUST.

Baton Rouge Water Works Co. serial gold sixes	9,000
Carolina Power & Light Co. convertible 5 per cent notes	202,500
Centerville Light & Traction Co. first serial sixes	3,000
Hudson Co. secured 6 per cent notes	1,500,000
Lake Charles Railway, Light & Water Works first sixes	15,000
Missouri Electric Railroad purchase money fives	700,000
Newport & Fall River Street Railway first fives	240,000
Noble County Telephone Co. 6 per cent bonds	5,000

Peoples Street Railway of Luzerne County (Scranton Railway) first sixes	$200,000
Philadelphia Co. 6 per cent collateral notes	250,000
Spokane Terminal Co. (Spokane & Inland Empire Railroad) first fives	12,500
West End Street Railway serial debenture fives	1,581,000
Western United Gas & Electric Co. general sixes	90,000
Wilkes-Barre & Kingston Passenger Railway first fives	40,000
Wilkes-Barre & Kingston Passenger Railway, John Graham real estate mortgage fives	50,000
Escanaba Traction Co. first and refunding fives	10,000
Bay State Street Railway 5 per cent coupon notes	57,000
Loveland Light & Water Co. first mortgage 6 per cent notes	4,400

SEPTEMBER.

Appalachian Power Co., collateral trust 7 per cent notes	2,195,700
Binghampton R. R., first fives	10,000
Canton Light, Heat & Power Co. (Canton Elec. Co.), first sixes	4,000
Chicago & West Towns Ry., first lien and collateral trust sixes	556,000
Denver Tramway Terminal Co., first serial fives	60,000
East Middlesex Street Railway, 5 per cent plain bonds	120,000
Green Bay Water Co., first sixes	5,000
Light, Fuel & Power Co. (South Haven Gas Co.), first fives	23,000
Mansfield Gas Light Co., first serial sixes	5,000
Minot Light & Telephone Co. (Northern States Pr. Co.), general sixes	5,000
Ohio Traction Co., 6 per cent coupon notes	300,000
Providence & Taunton Street Ry. (Bay States), first fives	150,000
Springfield Ry. Co., first fives	12,500
Wilkes-Barre & West Side Railway, 5 per cent bonds	35,000
Worcester Gas Light Co., 4½ per cent notes	300,000

OCTOBER.

Arvada Electric Co., first sevens	15,000
Caney River Gas Co., first refunding sixes	50,000
Central Illinois Utilities Co., first sixes	10,000
Cheyenne Electric Co., first gold fives	20,000
Christopher & Tenth Street R. R. first fours	210,000
Citizens Electric Light & Power Co. (Interstate Pub. Ser. Co.) first sixes	3,000
Citizens Gas, Electric & Heating Co., 6 per cent water fund certificates	4,000
Citizens Water Works Co. (Quincy, Ill.), first and second fives and six-and-a-halfs	12,000
City of Lincoln Gas Co. (Logan Co. Gas Co.), first sixes	95,000
Cleveland, Painesville & Eastern R. R., first consolidated fives	1,131,000
Cleveland, Painesville & Eastern R. R., first fives (extended)	500,000
Crystal City Gas Co., second sixes	10,000
Cumberland Street Ry. (Rhode Island Suburban Ry.), first sixes	69,000
Des Moines Street R. R., first sixes	25,000
Fairbury Gas Co., first sixes	31,400
Hornellsville & Canisteo Ry. (Hornell Trac. Co.), first fours	80,000
Iowa Southern Utilities Co., serial mortgage debenture sixes	10,000
Light, Heat & Power Corporation, 5 per cent 20-year coupon notes	50,000
Manufacturers Light & Heat Co., mortgage and collateral trust sixes	148,000
Milwaukee Coke & Gas Co., first fives	30,000
Minnesota & Ontario Power Co., first serial sixes	200,000
Minot Light & Telephone Co. (Northern States Pr. Co.), first sixes	2,000
National Light, Heat & Power Co., collateral trust 5-year 6 per cent notes	360,000
Philadelphia & West Chester Traction Co. first fives	400,000
Quincy Horse Ry. & Carrying Co. first consolidated fives	400,000
Reedy River Power Co. first fives	15,000
Sacramento Gas Co. first serial sixes	5,000

Shawinigan Water & Power Co. two-year 5 per cent notes	$2,500,000
Star Telephone Co. first sixes	2,000
Trenton Passenger Ry. first sixes	15,000
Twin States Gas & Electric Co. five-year 5 per cent debenture bonds	300,500
Woburn Light, Heat & Power Co. (Edison Electric Illuminating Co.) Boston 6 per cent bonds	137,000
South Penn Telephone & Telegraph Co. first serial sixes	1,500

NOVEMBER.

Ansonia Water Co. first fours	45,000
Central Kentucky Natural Gas Co. first serial sixes	40,000
Florida Power Co. first serial sixes	10,000
Great Bend Water & Light Co. serial fives	1,000
Hutchinson Gas & Fuel Co. first sixes	10,000
Newton Gas & Fuel Co. first sixes	5,000
Northern Ohio Traction & Light Co. collateral-trust sixes, first issue	100,000
Pembroke Electric Light Co. (Ltd.) first fives	3,000
Spring River Power Co. first fives	35,000
Waupaca Electric Light & Ry. Co. first serial sixes	2,000
Mystic Electric & Gas Light Co. first fives	24,000

DECEMBER.

Bay State Street Ry. 6 per cent coupon notes	357,000
Berkeley & South Norfolk Water & Electric Light Co. first mortgage sixes	150,000
Bristow Gas Co. first gold sixes	5,000
Detroit Ry. first sixes	50,000
Eastern Texas Electric Co. three-year 6 per cent notes	500,000
Fitchburg Gas & Electric Light Co. 4½ per cent coupon notes	35,000
La Grange Water, Light & Power Co. 5 per cent bonds	5,000
Midway Gas Co. first sixes, series A	180,000
New Castle Light & Power Co. first sixes	6,000
Pan Handle Traction Co. 6 per cent stock purchase notes	309,530
Pennsylvania Electric Co. five-year 5 per cent notes	400,000
Pittston Street Car Co. first sixes	99,000
Sauk Rapids Water Power Co. first fives	6,000
Wyandotte & Detroit River Ry. (Detroit United) consolidated fives	425,000
Easton, Palmer & Bethlehem Street Ry. first fives	200,000
Total	251,976,180

Public-utilities equipment trust obligations maturing in 1918.

JANUARY.

Cincinnati Traction Co., 5 per cent equipment notes, series B	$18,000
Cincinnati Traction Co., 5 per cent equipment notes, series C	11,000
Indianapolis Traction & Terminal Co., equipment 5 per cent certificates, series B	5,000
Inter-State R. R., equipment trust fives, series A	37,000
Market Street Elevated Passenger Ry., equipment trust fives, series A	32,500
Ohio Electric Ry., equipment 5 per cent notes, series A	8,000
Ohio Electric Ry., equipment 5 per cent notes, series B	7,000
Public Service Ry., equipment trust 6 per cent certificates, series A	40,000
Public Service Ry., equipment trust 6 per cent certificates, series B	22,000
Reading Transit Co. (Reading Transit & Light Co.), series A, fives	7,500
Staten Island Midland Ry., equipment trust 6 per cent certificates, series A	7,000
Union Traction Co., equipment trust fives	75,000
Oakland Traction Co., serial equipment bonds	31,000

FEBRUARY.

Chicago & Oak Park Elevated R. R., equipment 6 per cent notes	$8,000
Consolidated Traction Co., 6 per cent equipment trust certificates	28,000
Fort Wayne & Northern Indiana Traction Co., 5 per cent, series A, car-trust certificates	2,500
Hudson & Manhattan R. R., car-trust fives, series C	21,000
Lehigh Traction Co., 5 per cent, series A, equipment trust certificates	3,000
Metropolitan West Side Elevated Ry., equipment trust 5 per cent certificates, series A	102,000
Wilkes-Barre & Hazelton Ry., 5 per cent, series A, equipment trust certificates	4,000
Cincinnati Traction Co., 5 per cent notes, series E	10,000

MARCH.

Fort Wayne & Wabash Valley Traction Co., 5 per cent car-trust certificates	5,000
Hudson & Manhattan R. R., car-trust 5 per cent, series A	46,000
Indianapolis Traction & Terminal Co., equipment 5 per cent certificates, series C	5,000
Ohio Electric Ry., equipment 5 per cent notes, series D	5,000
Philadelphia Rapid Transit Co., equipment trust 5 per cent certificates, series B	175,000
Pittsburgh Rys., 5 per cent car trusts	27,000
Pittsburgh Rys., 6 per cent car trusts	18,000
Public Service Ry., equipment trust fives, series C	25,000
Union Traction Co. of Indiana, car-trust certificates, series A	6,000

APRIL.

Cincinnati Traction Co., 6 per cent equipment notes, series A	10,000
Cincinnati Traction Co., 6 per cent equipment notes, series D	17,000
Consolidated Traction Co. (Pittsburgh), 5 per cent car trust	20,000
Consolidated Traction Co. (Pittsburgh), 5 per cent equipment trust certificates	25,000
Fort Wayne & Northern Indiana Traction Co., 5 per cent, series B, car trust certificates	1,000
Gary & Interurban Railroad, 5 per cent equipment trust notes	11,000
Hudson & Manhattan Railroad, car trust fives, series B	25,000
Connecticut Co., equipment 5 per cent notes, series A	41,000
Orange County Traction Co., 5½ per cent equipment trust certificates	3,000

MAY.

Indianapolis Traction & Terminal Co., 5 per cent equipment certificates, series A	10,000
Philadelphia Rapid Transit Co., equipment trust 5 per cent certificates series C	81,000
San Francisco-Oakland Terminal Co., 6 per cent equipment notes	10,000

JUNE.

Empire United Railways (Inc.), 6 per cent equipment trust certificates, series A	10,600
Indianapolis Traction & Terminal Co., equipment 6 per cent certificates, series D	5,000
Ohio Electric Railway, equipment 5 per cent notes, series C	6,000
Wilmington & Philadelphia Traction Co., 5 per cent equipment notes, series A	10,000
United Railroad of San Francisco, 6 per cent equipment trust certificates	50,000

JULY.

Cincinnati Traction Co., 5 per cent equipment notes, series B	18,000
Cincinnati Traction Co., 5 per cent equipment notes, series C	11,000

Indianapolis Traction & Terminal Co., 5 per cent equipment certificates, series B	$5,000
Ohio Electric Railway, equipment 5 per cent notes, series A	8,000
Ohio Electric Railway, equipment 5 per cent notes, series B	6,000
Public Service Railway, equipment trust 6 per cent certificates, series A	40,000
Public Service Railway, equipment trust 5 per cent certificates, series B	23,000
Staten Island Midland Railway, equipment trust 6 per cent certificates, series A	6,500
Union Traction Co., equipment trust fives	75,000
AUGUST.	
American Railways Co., car trust 6 per cent certificates, series A	15,000
American Railways Co., car trust 6 per cent certificates, series B	11,000
American Railways Co., car trust 6 per cent certificates, series C	11,000
Chicago & Oak Park Elevated equipment 6 per cent notes	8,000
Fort Wayne & Northern Indiana Traction Co., 5 per cent, series A, car trust certificates	2,500
Hudson & Manhattan Railroad, car trust fives, series C	21,000
Lehigh Traction Co., 5 per cent, series A, equipment trust certificates	3,000
Metropolitan West Side Elevated Railway, equipment trust 5 per cent certificates, series A	103,000
Wilkes-Barre & Hazelton Railway, 5 per cent, series A, equipment trust certificates	4,000
Cincinnati Traction Co., 5 per cent equipment notes, series E	10,000
SEPTEMBER.	
Fort Wayne & Wabash Valley Traction Co., 5 per cent car trust certificates	5,000
Hudson & Manhattan Railroad, car trust fives, series A	46,000
Indianapolis Traction & Terminal Co., equipment 5 per cent certificates, series C	5,000
Ohio Electric Railway, equipment 5 per cent notes, series D	5,000
Philadelphia Rapid Transit Co., equipment trust 5 per cent certificates, series B	175,000
Pittsburgh Railways Co., 6 per cent car trusts	19,000
Public Service Railway 5 per cent equipment trust certificates, series C	25,000
Union Traction Co. of Indiana, car trust certificates, series A	7,000
Connecticut Co., 4½ per cent equipment notes, series B	46,000
OCTOBER.	
Cincinnati Traction Co., 5 per cent equipment notes, series D	17,000
Consolidated Traction Co., 5 per cent equipment trust certificates	25,000
Fort Wayne & Northern Indiana Traction Co., 5 per cent, series B, car trust certificates	1,000
Hudson & Manhattan Railroad, car trust fives, series B	25,000
Connecticut Co., equipment 5 per cent notes, series A	41,000
NOVEMBER.	
Indianapolis Traction & Terminal Co., 5 per cent equipment certificates, series A	10,000
Northwestern Elevated Railroad, equipment trust 6 per cent notes	16,000
Philadelphia Rapid Transit Co., equipment trust 5 per cent certificates, series C	51,000
San Francisco-Oakland Terminal Railways, 6 per cent equipment notes	10,000
DECEMBER.	
Indianapolis Traction & Terminal Co., 6 per cent equipment certificates, series D	5,000
Ohio Electric Railway, equipment 5 per cent notes, series C	6,000
	2,078,100

Mr. Crowell, a member of the Public Utility Committee, is here, and we will be glad to hear him.

STATEMENT OF MR. H. H. CROWELL, MEMBER OF THE UNITED STATES PUBLIC UTILITY COMMITTEE, GRAND RAPIDS, MICH.

Mr. CROWELL. Mr. Chairman and gentlemen, of course, the status of these public utilities, as you know, is different from that of the steam railroads, but they represent a capitalization of over $8,000,000,000, and an annual gross revenue of over $1,600,000,000. The public utilities, electric, gas, and street railways, functionally and inherently, are State institutions. They are regulated by the State and municipal authorities, but, inasmuch as they furnish over 60 per cent of the power used in the industries, and inasmuch as they transport 80 per cent of the factory employees and, perhaps, will be called upon to furnish 30 or 40 per cent of toluol for explosives, which are so vital for the war program, we venture to trespass upon your time to show the situation we are in. We are ground between the upper and nether millstones.

There are three essential factors in a public-service corporation. One is, if it is located in a normal town, it is never a finished proposition; second, it turns its capital very infrequently, and those two points, considered together, make for a constantly increasing financial program; and third, increasing cost of operation and a limit upon its ability to raise its rates.

Now these utilities are suffering from three main causes, the inability to sell their long-term, commission-approved bonds; their inability to finance their maturing obligations, and the increasing cost of operation, due partly to Government mandate, and generally to Government war conditions. These corporations can not continue to furnish this service, nor increase the service they are called upon to furnish on account of the demands of the war situation, with impaired credit, with an inadequate plant, and with an insufficient income.

A bill of this kind, looking toward the relief of institutions which are caught in this emergency should, we think, carry with it protection or help for the public utilities if their service is to be continuously rendered. That is all we have in mind, to put before you the general situation which is more clearly set forth in the brief that our committee has prepared and which has been filed here. We believe that it will be necessary to provide some direct means for taking care of the maturities of these corporations. If they are called upon to make extensions to help carry out the war program, then the money, of course, would have to be provided for that through some emergency channels. If a national bill should refer to the public utilities as a class, and a provision was made for solvent public utilities, to take care of their maturing obligations, it would have a very beneficial effect upon the State and municipal authorities who have absolute control of their service and rates charged, and the extensions which they must make under franchised conditions or under the orders of public-service commissions who regulate their service and charges. That is the picture of our situation.

Our costs have increased so much that we can not sell any of our stocks at par, which by the law of the States we are required to sell at par. Our costs have increased so much that we can not, under the language of the indentures which we have, sell any of our bonds at par. We find for these maturing obligations that the rivers of finance have dried up, and we have no moneys available for our instant needs. That is, in general, the situation that faces the public-utility corporations.

The CHAIRMAN. Suppose your maturing obligations amounted to $1,000,000 and your bonds that you are to refund were only worth in the market $800,000; would you expect this corporation to loan you $1,000,000?

Mr. CROWELL. No, sir.

The CHAIRMAN. Or expect it to loan you only to the extent of the market value of your securities?

Mr. CROWELL. I would expect the loan to be made in accordance with what they were worth.

The CHAIRMAN. Not in excess of the market value?

Mr. CROWELL. Not in excess of the real market value, and there should be a margin there, of course. If bonds were really worth but $800,000, one would not expect the Government corporation to loan $1,000,000; but if no normal market existed, one would expect a loan on the basis of the real worth of the bonds; it would be solely on account of the abnormal conditions and because of no normal market that solvent public-utilities corporations would go to the finance corporation for relief. Such finance corporation would require the usual margin of safety in the usual market.

The CHAIRMAN. How would you take care of that, if that was not sufficient to raise the money that you need?

Mr. CROWELL. It is possible to resort to the local banks for current needs, or for differential, or the difference between the sale price, or we would expect discounts on the term security. I did not mention that these public utilities have probably in the banks approximately $300,000,000 of short-time paper, which is not two-name paper, which is single-corporate name paper; and, if a bill of this kind is passed, and in that bill something directly was had looking toward a channel for the renewing of these long-term maturities, it might be possible for us to still continue to get local accommodations for our current requirements.

Senator JONES. Do you expect those maturities to be renewed at a rate of interest which could bring them up to par?

Mr. CROWELL. No, sir; to be renewed on the basis of the then existing value of the money, assuming that the money is a commodity—not an excess value.

Senator GALLINGER. Do you anticipate that at the close of this horrible war, and we are all hoping it will close in the not distant future, that your concerns will increase in value?

Mr. CROWELL. Yes, sir.

Senator GALLINGER. That normal conditions will be resumed to a large extent?

Mr. CROWELL. Yes, sir.

Senator GALLINGER. And that your securities value will be much greater than now?

Mr. CROWELL. Yes, sir. I am speaking here and pleading wholly for those solvent public-utility corporations that are caught by these conditions that are absolutely beyond their control.

Senator WILLIAMS. I would like to ask a question just to arrive clearly at your purpose. Clause "d" of section 6 of this bill provides that this corporation shall have the power—

In exceptional cases to make advances directly to any person, firm, corporation, or association whose operations shall be necessary or contributory to the prosecution of the war, for periods not exceeding five years from the respective dates of such advances, upon such terms, and upon the security of such bonds, notes, or obligations, and subject to such rules and regulations as may be prescribed by the board of directors of the corporation, with the approval of the Secretary of the Treasury.

Your object is to take yourselves out of the class left to the discretion of this board and to name yourselves in express terms so that they will be compelled to regard you as an exceptional case necessary or contributory to the prosecution of the war, and you are not willing to be left under this general discretionary clause?

Mr. CROWELL. I would prefer that on account of the vital necessity that we are as a whole to this war program, we should be recognized as a class that is vitally necessary to the war.

Senator WILLIAMS. In express terms in the law, and have the discretion taken away from the corporation. Why do you think that, if the corporation is to be intrusted with that discretion, and the board of directors is to determine when cases are exceptional and when they are contributory and necessary to the prosecution of the war in all other cases, every public utilities corporation in the United States should be made an exception in express terms instead of being left to the discretion of the corporation?

Mr. CROWELL. It depends, of course, upon the construction of the words "exceptional cases." Public utilities, whose receipts and incomes are fixed on a prewar basis——

Senator WILLIAMS. I understand that, but this corporation is given this discretion. Of course you do not mean that every public utilities corporation in the United States is suffering from these conditions. Why can not you leave it to the discretion of that board to determine in each case whether or not that case falls within this discretion of the corporation?

Mr. CROWELL. If it is permissive for those corporations which are solvent in ordinary times and who are so necessary to the war, specifically to come to this corporation for the relief that they may vitally need, that would be sufficient for the purpose.

The CHAIRMAN. As there are several more who desire to be heard we will have a hearing to-morrow at 10 o'clock.

Senator GORE. Mr. Crowell, you say you have outstanding some $300,000,000 of short-time obligations.

Mr. CROWELL. Approximately, yes.

Senator GORE. Were they issued principally to take care of current expenditures or maturing obligations?

Mr. CROWELL. They were issued in many cases to take care of constructional expenditures, pending the time when consent should be obtained from the public-service commissions for issuing bonds to reimburse the company for such expenditures. Those proceeding

are sometimes long drawn out, and this situation generally, as expressed by me, is in part the result of an accumulation of those things. I might give one example. A concern had an $11,000,000-construction program, which construction program, on account of the war, it reduced to the very lowest terms, apparently, to six and a half million dollars under normal current prices. The excess current prices increased the expenditures up to $11,000,000 again. They were only able to finance a part of that construction program, because they found themselves in a position where the commission-approved securities, showing that they had made those expenditures, could not be sold. There is no market for those long-term bonds, such as they usually have to reimburse themselves, and hence they are left to the mercy of the short-term accommodations at excessive prices, and they can get no relief at all.

Senator GORE. The operating expenses of the railroad companies generally average 65 per cent of the revenue?

Mr. CROWELL. Seventy-two per cent of the operating revenue.

Senator GORE. Is there any such established ratio between the operating expenditures of the public utilities corporations and their revenue?

Mr. CROWWELL. Yes, sir. I should say the capital of a public utility corporation might be turned once in five or six years. If you had an investment of $100,000, you might expect a gross of $20,000, assuming that it was a constructional proposition pure and simple. With $20,000 gross revenues the convention might be, if the operating expenses were 60 per cent, $8,000, or 8 per cent on the hundred thousand dollars. The concern, if it has a very economical prime mover, might reduce those expenses to 52 or 50 per cent; if there is an expensive prime mover, there might be expenses amounting to 60, 70, or 75 per cent under normal conditions, but under the conditions that prevail now many find their operating expenses have increased 100 per cent.

Senator GORE. And they have consumed their operating revenue.

Mr. CROWELL. And when you bear in mind that by reason of the mandates of the franchises, by reason of the orders of the public-service commissions and the growth of the communities, that they are never finished propositions, and that while they are operating and functioning as public-utilities corporations they are carrying on a construction program it is very easy to see that even under normal conditions they have to have a continuously expanding financial program.

Senator GORE. Would those ratios apply to gas companies and electric light and railway companies?

Mr. CROWELL. Those conventions might apply to gas companies and some electric companies and railways and run as high as 75 or 78 per cent. The ratio would be lower with hydroelectric companies.

Senator LODGE. Of course you are assuming that with this system of rates imposed by municipalities or States the rates do not rise as they ought to rise?

Mr. CROWELL. And there is no short-time method of raising rates for emergency conditions. It is a long-drawn-out proposition, and it requires valuations and large expense and a great deal of time, and

that is the reason why a public-service corporation which has had its rates fixed once under normal conditions has no excess profit to take care of these lean years. It can not get a fund to take care of an emergency, what we call a buffer fund in an industrial proposition, and therefore there is nothing to draw on in an emergency of this kind. The bottom is pulled out of the pail.

Senator TOWNSEND. You are asking for no consideration except for financially safe and sound concerns?

Mr. CROWELL. No; simply the recognition by this committee that our necessities are vital to the Government's war program. I have been told by people in authority that we are now 200,000 kilowatts short of the capacity required by the Government. That means 250,000 horsepower, roughly speaking, for the country. Take the situation of the company I represent. We have a plant half completed with no chance to get money to complete it. It would take another million dollars. It is a hydroelectric proposition. If we can get that million dollars and complete that plant, we would save $260,000 a year in coal.

The CHAIRMAN. We will now adjourn until to-morrow.

(Thereupon, at 12.15 o'clock p. m., the committee adjourned to meet at 10 o'clock a. m. to-morrow, Wednesday, February 13, 1918.)

ESTABLISHMENT OF A WAR FINANCE CORPORATION.

WEDNESDAY, FEBRUARY 13, 1918.

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to adjournment, at 10 o'clock a. m., in the committee room, Capitol, Hon. John Sharp Williams presiding.

Present: Senators Williams (acting chairman), McCumber, and Gallinger.

Senator WILLIAMS. Senator Simmons asked me to explain that he would not be here, because he had to go down to one of the departments, and he asked me to act as chairman.

Senator GALLINGER. Mr. Couch is here from Concord, and he wishes to be heard briefly in reference to this bill.

Senator WILLIAMS. Mr. Couch, please state your full name, address, and whom you represent.

STATEMENT OF MR. B. W. COUCH, TREASURER OF THE CONCORD GAS LIGHT CO., CONCORD, N. H.

Mr. COUCH. Mr. Chairman and gentlemen, I am president of the Concord Gas Light Co. and am also a savings-bank man from a savings-bank city, Concord, N. H.

Senator GALLINGER. You are also a practicing lawyer, are you not?

Mr. COUCH. Yes, sir; I am a lawyer. I am very much interested in this subsection *c*, relating to savings banks. The trouble to come to the savings banks is not going to be that the banks can not voluntarily extend credits in the savings-bank business; it is coming to the savings banks entirely because of the withdrawal of deposits by those proposing to buy Liberty bonds. It has hurt some already in this way. We have had to call various obligations coming due in order to maintain our cash reserve. So it has been with the savings banks almost throughout New England. That has had a widespread effect. It has not been very bad yet, but it will be. Under our State laws our assets are not very liquid; investments have to be made so conservatively that the great bulk of them can not be moved.

Now, up in New England, unless the Congress passes some act with a clause in it like section *c* the trouble is coming to the savings banks because they will not be able to maintain the cash, and as soon as the people—and by "people" I mean the very small investors; those are the men and women who invest in the savings banks—will

become scared, and when they become scared an avalanche of trouble will start, because there is no worse place for something to start than in the savings banks.

I was very much gratified the day of the first hearing to hear the Secretary of the Treasury, in answer to a question by the Senator from New Hampshire, say he would not be at all opposed to extending the 90-day limit to six months or a year. I hope very strongly that this committee will see fit to make it not less than a year, if it puts in any limit at all. I hope that upon consideration in executive session the committee will see fit to leave the matter of limit entirely to the board of directors of this Finance Corporation.

Just one sentence in regard to subsection *d*, which relates to the granting of aid to all public utilities without going through the Federal reserve banks but straight across to this corporation. I have listened with a great deal of interest to what has been said. It seems to me that there is a stumbling block in the bill. It has occurred to me that the suggestion made by the Senator from Oklahoma yesterday was good, which was that the exercise of the authority under that subsection *d* be limited to renewals and not apply to new issues, so that these brand-new war-working corporations——

Senator WILLIAMS. You mean taking your matured obligations?

Mr. COUCH. Matured obligations; that is what I mean by renewals. So that these war-working corporations with their new issues, if they desire to come in under this act, must get themselves into a financial position where they can get through and by the Federal reserve before they get to this corporation.

Senator WILLIAMS. Thank you, Mr. Couch. As there does not appear to be any others who desire to be heard now, the committee will adjourn until to-morrow at 10 o'clock.

(Thereupon, at 10.30 o'clock a. m., the committee adjourned to meet at 10 o'clock a. m. to-morrow, Thursday, February 14, 1918.)

ESTABLISHMENT OF A WAR FINANCE CORPORATION.

THURSDAY, FEBRUARY 14, 1918.

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to adjournment, at 10 o'clock a. m., Hon. F. M. Simmons (chairman) presiding.

Present: Senators Simmons (chairman), Stone, Thomas, Jones, Gerry, Lodge, Smoot, and Townsend.

The CHAIRMAN. Mr. Strong, we would be glad to have your views about this proposed legislation.

STATEMENT OF MR. BENJAMIN STRONG, GOVERNOR FEDERAL RESERVE BANK OF NEW YORK, NASSAU AND PINE STREETS, NEW YORK CITY.

Mr. STRONG. I am governor of the Federal Reserve Bank of New York.

Senator STONE. Before you took this position you were in banking in New York?

Mr. STRONG. I was president of the Bankers' Trust Co. in New York. My particular interest in this bill arises, as you doubtless understand, from the fact that it has direct bearing upon the operations of the Federal Reserve banks, and likewise some other legislation has been proposed in a bill introduced by Mr. Calder, of New York, which would have a somewhat similar effect upon our operations; on that account we have given some study to this subject, particularly in New York, which is the principal security and money market of the country. My appearance, Mr. Chairman, has been on very short notice, and engagements at the bank have been so pressing that I have had no opportunity to prepare a formal written statement, so I hope you will overlook the deficiencies of my statement which will be made from some brief notes.

Senator SMOOT. You have been asked to come as a witness by whom?

Mr. STRONG. It was originally discussed with some of the members of the Federal Reserve Board, and I subsequently discussed the matter with some of the members of the Treasury Department as to my appearing to make a statement here.

It has become increasingly apparent to us in New York, and doubtless in other parts of the country, that there is need for financial relief, particularly in the matter of furnishing of capital, to the corporations of the country, principally the industrial and public-utilities corporations. The security markets have been very largely

closed to the customary capital borrowing of these corporations by reason of the enormous borrowings of the Government of the United States, and there has developed quite naturally some reluctance to purchase securities on the part of timid investors. Some who feel that they can not afford to purchase the obligations of the Government at the low rates of interest they bear are not now buying the securities of corporations bearing higher rates and which in time of peace they would not hesitate to buy. It is one of the influences of war conditions when fear and timidity arise on the part of investors; and those two factors operating together have practically closed the investment market to the borrowings of corporations that really need very much to enlarge their productive capacity, many of them in fact in order to furnish the Government with its war requirements.

Senator STONE. Is that true of all classes of industrial corporations?

Mr. STRONG. Almost without exception.

Senator STONE. I asked especially with reference to corporations engaged in Government work, manufacturing munitions and things of that kind.

Mr. STRONG. It is true, even of those corporations, distinguishing, however, between the credit that those corporations are able to get, in the form of short loans, principally from banks, and the credit which they should be able to get as new capital on long-time obligations or by the issue of stock in the investment market. I know of very few cases where any long-time bonds have been sold recently by any corporations in the country. The sales of bonds now taking place are principally and almost entirely confined to the obligations of municipalities and, possibly, of States which have various exemption provisions that give them a special market under almost any conditions.

Senator SMOOT. That is reflected in the sale of our 4 per cent Liberty bonds, which, I notice, are now below 95.

Mr. STRONG. Yes, sir. Of course, in addition to the requirements of corporations of those two classes, industrial and public utilities, the transportation lines also require more capital in order to enlarge their facilities. There are immense maturities of obligations falling due this year owing by railroads, industrial, and public utilities corporations that must be taken care of, and there is also something like $450,000,000 or $475,000,000 of obligations of various kinds of foreign governments that are maturing in this market this year.

Senator SMOOT. Is that besides the $750,000,000 of our institutions?

Mr. STRONG. Yes, sir; it is in addition to that. I have not the figures here, Senator Smoot, but I believe it will be found that the maturities of railroad corporations, public-utility corporations, and industrial and miscellaneous corporations aggregate over $600,000,000. The bonds of municipalities, plus their temporary borrowings which must be retired in some way by the issue of long-term bonds, would probably run somewhere from $450,000,000 to $500,000,000. It is estimated that in addition there are over $450,000,000 of foreign obligations maturing.

Senator SMOOT. About $1,700,000,000 altogether?

Mr. STRONG. Yes, sir.

Senator STONE. What are the foreign obligations?

Mr. STRONG. Principally collateral notes of the British Government and, to some extent, credits arranged in the form of bills in behalf of French borrowers in this country, and some miscellaneous borrowings.

Senator STONE. Is it your idea that this Government should provide for money to take care of those?

Mr. STRONG. Of the foreign governments?

Senator STONE. Yes.

Mr. STRONG. I have not had much to do with that, because it is a subject really by itself. Those are secured obligations, and I naturally would suppose it would be a matter of negotiation between those Governments and our Government.

Senator SMOOT. Those Governments will certainly want their money, will they not?

Mr. STRONG. They certainly will need to meet those maturities, and it has a direct bearing upon this whole problem of caring for the great mass of securities falling due.

The CHAIRMAN. Will you state specifically exactly how those obligations are secured?

Mr. STRONG. I believe there are two issues, totaling $350,000,000. I can insert the exact particulars in regard to that when I read the report of my remarks, but I believe there are two issues of the United Kingdom which mature this year that are secured in the main by the securities that were assembled under a scheme set up by the British Government to get possession of the investment securities of their citizens and use them as the basis of credit in this country, and those consist largely of railroad and industrial bonds and bonds and stocks of neutral foreign Governments and of the British colonies and dominions. A large amount of Canadian securities is included in that collateral, and I understand there is a wide margin of value in the collateral over the face amount of the obligations maturing.

Senator STONE. Of course, if these Governments—the French Government and the British Government—should take up their obligations which have been bought by our people, it would add to that extent to the volume of available money in this country for loaning at home, would it not?

Mr. STRONG. It would, sir; but may we not expect that those obligations will be taken up by placing some other kind of obligations in this country?

Senator STONE. That may be. The idea is that the British and French Governments would find it difficult to raise that amount of money to redeem collateral.

Senator SMOOT. It will be impossible for them to do it, because we are advancing money now to pay their running expenses.

Senator STONE. And hence it would follow that this Government would in some way have to take care of that problem.

Mr. STRONG. It seems to me that is unquestionably the case as long as we are advancing money to them now to pay for all of their purchases in this country.

The CHAIRMAN. That paper runs for a much longer period than three months, as I understand it.

Mr. STRONG. There were a number of series issued payable, I think, in one year or two years or three years.

Senator SMOOT. One, two, and three years.

Mr. STRONG. Yes, sir; but they have heavy maturities this year.

The CHAIRMAN. They are held by banks?

Mr. STRONG. They are very largely held by investors, too, Senator Simmons. There was quite a wide distribution made when those securities were issued in this country to investors as well as to banks.

Senator STONE. In the beginning they were scattered pretty broadly; but I suppose they were scattered chiefly among the smaller banks; the large banks of the Middle West and New York first took them and then put them out to their correspondents.

Mr. STRONG. Yes, sir. There is no data available to disclose just what amount of maturing obligations are held by our banks. About a year or more ago the Comptroller of the Currency called for a report which would disclose the amount of foreign obligations held by all of the national banks, but that report did not separate them in such a way that we could ascertain how much of those held by banks fell due this year.

Senator SMOOT. Do not the savings banks of the country hold a great many?

Mr. STRONG. Undoubtedly.

Senator STONE. I would not be surprised if that were the case.

Mr. STRONG. It seems to me that there are only four courses possible by which the necessary financing may be done to take care of the needs of these corporations. One is to refrain from any direct or indirect Government aid and force them, so long as the market for investment securities is closed, to borrow money at the banks, which is what they are doing to-day. The second is to have the Government intervene and give direct aid, and in consequence of that very much enlarge its direct borrowing on its own bonds. The third is to provide an instrument or agency for indirect aid, such as is provided by this bill, by the creation of a corporation. The fourth would be to amend the Federal reserve act so as to admit of more direct borrowing than is contemplated by this bill from the Federal reserve bank upon the collateral of securities, as was suggested by the Calder bill. My present opinion is that in default of the employment of some one of the last three methods of aid suggested, the time is coming when many corporations will face very serious embarrassment, not only through inability to extend their operations and fill Government contracts but because of inability to meet their maturing obligations——

Senator SMOOT. Not only embarrassment but bankruptcy.

Mr. STRONG. Bankruptcy; yes, sir; and after a good deal of consideration of the various suggestions that have been made I have been led to the conclusion that this bill provides the best and wisest suggestion for dealing with the subject, and I am led to that conclusion principally becauses it combines the two operations that are necessary to avoid, on the one hand continuance of an unsound expanding condition of our business, by imposing a restraint upon credit that would make possible that condition—that is, the system of licensing, and at the same time furnish aid to corporations which are deserving of it, but can not market their securities.

The CHAIRMAN. Curtailing?

Mr. STRONG. Curtailing. Let me illustrate by assuming, if I may, that this is simply a plan to furnish financial aid to corporations without any machinery for curtailing unwise or unnecessary credit. It would mean that the business in all nonessentials would continue as it has in the past, without any restraint, and the result would be expansion of credit so far as necessary to conduct the unusual war production of the country, and that would certainly lead to a dangerous expansion of credit.

The CHAIRMAN. Under the stimulation of these high prices, do you not think the conditions you have just described of these nonessentials would injuriously affect the essentials?

Mr. STRONG. Unless means are provided promptly for the restraint of the unwise extension of credit to nonessential industries. The mere addition of Government aid in any form to the war industries of the country means expansion, and the operation of these two things together properly conducted would involve a corresponding prompt but not a disastrous curtailment of credit to nonessential industries, which would help to develop a vacuum so that the essential industries could be financed. I regard the coupling of those two operations together in a sense under one management as essential to the success of either plan, that of curtailing credit or of extending aid.

Senator STONE. I would like to get this clear in my mind: If what we call essential industries, those engaged in Government contracts, for example, can not secure the means from the banks or investors to expand their industries or to maintain them, how would the new nonessential industries secure means with which to start something new?

Mr. STRONG. Our competitive bank system is such that there will be a constant employment of bank credit for the so-called nonessential industries so long as the banks find it is profitable to extend that credit, unless they are restrained in some way. I was going to touch upon that a little later, Senator Stone, as it bears on another phase of the plan. I have taken the liberty of bringing with me three typical examples. They happen to be public-utility corporations where Government aid or some kind of financial aid is needed, and where assistance to those corporations seems to be essential to the prosecution of actual war work. I will be glad also to submit a statement in writing in detail, omitting the names of these corporations, to put in the record. One of them happens to be a public-utility corporation that furnishes power to coal mines in an important coal-producing section of the country. The demand for opening new mines and enlarging the production of existing mines has been very insistant, and this company, which is not a very large one, engaged itself to enlarge its facilities for that purpose. It made contracts for power with coal producers, and now finds itself, right in the middle of the coal-producing section, unable to get coal to operate its own power plants, because of the demand upon its customers for coal from other sources. They can not be certain of a supply, and in order to insure a sufficient supply of coal to enlarge the production of current for the operation of many mines in this territory the power company is to-day borrowing $800,000 in small

amounts from little banks scattered throughout the territory where it operates.

Senator TOWNSEND. Why can it not get coal if it is organizing for the purpose of helping the coal mines?

Mr. STRONG. Presumably the insistent demands for coal from the customers of the coal mines in that territory have led to an actual curtailment of the supply of coal for this plant.

Senator TOWNSEND. Has that been the result of the orders of the coal administration?

Mr. STRONG. That I do not know.

Senator SMOOT. That is the only way in which it could be done, is it not?

Mr. STRONG. I have a statement from the president of the company on that point, but I do not think he gives the specific reason.

Senator STONE. The question of Senator Townsend suggests rather a peculiar situation. If this power is necessary for the operation of the mines, and yet the mines needing this power find themselves unwilling to supply the coal which is necessary——

Senator SMOOT. They may be unable, instead of unwilling.

Senator STONE. I would think that would be the first kind of purchaser they would supply.

Mr. STRONG. May I read the statement of the president of the company?

(The statement referred to by Mr. Strong is here printed in full, as follows:)

The greater part of the companies' electric energy is sold as power to coal operators, manufacturers of fire brick and other clay products, and iron and steel mills and foundries, the remainder to small industries and utilities, including electric railways and small electric lighting companies, and to the lighting and commercial customers in (name omitted), and some 30 or 40 towns and villages in which the companies conduct an electric lighting and power business.

The output of electric energy of the companies was something more than 50,000,000 kilowatt hours in 1917. About 75 per cent of this output was sold as power, of which some 90 per cent was used by coal mines and steel and iron mills and foundries. It may be said that none of the output of the companies was sold to industries not essential to the present activities of the Government, the principal business of the territory occupied being the production of coal and manufacture of steel and iron and allied industries.

The three companies are now supplying power to about 170 coal operations having an annual capacity of approximately 17,000,000 tons of coal; the actual shipments from these operations approximate 50 per cent of their capacity, dependent upon market and regularity of car supply.

For a period of nearly 18 months the several power stations of the electric companies mentioned have (notwithstanding their being located in a coal producing and mining territory) frequently experienced great difficulty in obtaining a sufficient supply of coal to meet their daily requirements. Owing to the annoyance, inconvenience, and expense incurred, and the possibility of interruptions in service to their patrons, the management of the companies evolved a plan for acquiring coal rights, by ownership and lease, and opening mines in the immediate vicinity of the power stations of the companies located at (names omitted), the general plan of which is outlined in the bond circular recently issued for the purpose of disposing of $450,000 of bonds to provide funds necessary to develop and equip the coal properties owned and leased.

The coal company is owned and controlled by the same interests and is under the same management as the other companies covered by this memorandum, and was incorporated for the purpose of at all times insuring the power stations mentioned with a supply of coal equal to their requirements.

Contracts have been let for sinking and driving shafts, for electrical equipment, etc.; the work of development is progressing on all the properties, and

two of the power stations are now being supplied with coal by the (name of coal company omitted).

A considerable part of the bonds of the coal company have not been disposed of, not because of any criticism of the bond as an investment, but due to the prevailing disposition of investors to make no purchases—in fact, no commitments for purchase.

The several companies herein referred to expended for extensions and additions to their property during the year 1917, $916,000.

Their commitments on additions and extensions made in 1917 and not yet completed represent expenditures that must be made during the year 1918 of $544,000. The probable requirements of the companies for extensions and additions to their property during the year 1918 will amount to $294,000. Total funds required during 1918 for extensions and additions to the companies' property, $838,000.

The companies have obligations outstanding, largely to banks in the form of demand or short-term notes, amounting to about $800,000. These obligations are the result of the inability of the companies to dispose of their securities, owing to the conditions that have existed during the past 18 months. The companies have not before in their history found it difficult to market their securities at a fair price, but at the present time find themselves unable to dispose of securities to provide the $838,000 that will be required for extensions and additions in their territory or to liquidate their outstanding notes of $800,000. Besides this, the [name omitted] coal company will require $50,000 to develop and equip its property, making a total of something more than $2,000,000 required by all of the companies mentioned in this memorandum.

It should be understood that the management of these companies has not expended this very considerable sum of money for additions to property and incurred the obligations and indebtedness incident thereto for the sole purpose of extending their territory and building up their business in times such as have existed for two years past; on the contrary, the expenditures heretofore made and now confronting the companies have been forced upon them by the demands of the communities served, supported by the requirements of the public-service commission of [name omitted] and in a large measure by the demands of the operators of coal mines and manufacturers of fire brick and steel and iron products for a supply of power with which to meet their obligations incident to the war situation. In other words, the construction program of these companies during 1917 was not based upon a desire to expand their territory and business, but was controlled by the demands for additional power principally by coal operators; the same is true of the expenditures for construction they are confronted with for the present year.

The surplus earnings of the combined companies (excluding the [name omitted] coal company for the year 1917 were approximately $200,000, being considerably less than during the preceding year, owing to the tremendous advance in the cost of labor and materials; increased rates and added economies will, we believe, bring the surplus earnings for the year 1918 up to approximately $300,000. In as much as the companies do not pay dividends on either their preferred or common stock (and have not done so for several years, with the exception of $12,000 on $200,000 outstanding preferred stock of the [name omitted] company) nearly all of the surplus earnings for 1918 will be used for extensions and additions during that year, though, of course, these earnings will not be available until after such extensions and additions must be made.

Senator TOWNSEND. Do I understand from your reading of that that you get the same idea I do, namely, that they are compelled to get this additional capital for the purpose of acquiring mines to furnish coal to create the power that is used and necessary to be used by the miners themselves?

Mr. STRONG. About one-fourth of the amount of money appears to be for that purpose, $450,000, but in addition to that they have $800,000 of bank debt, and they have a construction account of $836,000 for their normal extensions and enlargement of their plants.

Senator TOWNSEND. Do you not think it is very pertinent to find out why they can not get coal?

Mr. STRONG. This is one of the corporations which, after a time, will likely make application for relief from the Government, and when that application is made all of those matters will be brought out.

Senator TOWNSEND. Ought not that matter to have been investigated long ago, because if you furnish the coal to that company it would aid in the production of coal?

Mr. STRONG. Yes. It would have furnished power to enlarge the operations of 170 mines in this territory.

I have another case here that illustrates very clearly the relation between the fuel question and capital for public utilities corporations. This was brought out in a letter which I received from a personal friend, who had no expectation that I would use his letter in connection with this hearing. He sends me a copy of a letter from a fuel administrator which is quite long, but the effect of which is practically to require this company to expend $8,500,000 in the development of hydroelectric plants in order to effect a saving in the consumption of oil, which is used in this particular territory. This plant happens to be located in an oil-producing country. In consequence of the enforcement of that order, failing to get capital to continue its construction work, there would have to be a very large curtailment of power in other directions, which would, of course, be imposed upon some of the customers of that company. They proposed, I believe, an enlargement of about 35,000 horsepower to their productive capacity. Naturally they have got to go to the banks and borrow money for capital purposes to comply with the suggestion of the fuel administrator, which is the very thing which ought to be avoided at this time if possible.

Senator SMOOT. The fuel administrator ordered them to expend this amount of money?

Mr. STRONG. He did not claim the power to order it; no, sir. May I read a part of this letter, Senator Smoot? Referring to various reports made by the corporation to the local public-service commission, he states [reading]:

> In the report submitted by the [name omitted] companies to the railroad commission and this office bearing upon the question of fuel conservation, I note that your company has under construction and has performed some work on a hydroelectric plant known as [name omitted]. I also note that this plant can be completed and placed in operation under favorable conditions as to material and shipments thereof; also that your company has in contemplation the construction of a reservoir on [location omitted] which can be finished in the year 1918, so as to utilize the 1919 run-off of the watershed tributary to [stream name omitted] both in [name omitted] reservoir and [name omitted] power plant No. 2 of your company's [name omitted] system.
>
> I also note that your company has under contemplation a plan for adding a further generating unit of 16,000 kilowatt capacity in your [name omitted] power plant No. 2. I have caused some figures and computations to be made as to what the results will be in the matter of production of hydroelectric power if your company proceeds with energy and diligence to do the three things above outlined. My information is that if all of this work is proceeded with vigorously and energetically there will be in the year 1919 produced and available for use upon your system additional hydroelectric power to the extent of 62,000,000 kilowatt hours, or the equivalent of approximately 300,000 barrels of oil; that during the year 1920, upon the final completion of these various projects and thereafter, the hydroelectric output of these three projects will be 233,000,000 kilowatt hours annually, the equivalent of approximately 1,100,000 barrels of oil. My understanding and information is that the cost of these three projects, viz, [names omitted], will be approximately $8,500,000.

This office believes that the completion of the work herein outlined is, from the standpoint of the successful prosecution of the war, vitally essential; and I believe that your company, notwithstanding present conditions as to prices and material, should proceed with this work at once and prosecute it vigorously to completion. Your company has a very large system in [location omitted] serving a very large territory, and you have assumed duties and obligations which in this time of national need I strongly feel you should not hesitate to perform, even at some sacrifice to yourself.

In view of the character of the service rendered by your company throughout a very large portion, if not all, of the territory which you serve, I should be very loath to be compelled by the stress of the situation in respect to fuel oil to take any action which would shut off service to any of the customers whom you are now serving, and I sincerely trust that any such action on the part of the fuel administration will be unnecessary by your action in providing additional hydroelectric power. You seem to have the facilities and opportunities for accomplishing this purpose.

If this office should order curtailment of your nonessential lighting which is approximately 10 per cent of your total load, and 30 per cent of your revenue, this would be insufficient to effect a material saving of fuel oil. In consequence, a fair share of your power load would also have to be curtailed, together with the nonessential lighting load, in order to effect a reasonably adequate fuel oil saving. In view of the large contracts now held by (name of district omitted) shipbuilding plants, in a very short time the (name of district omitted) will have a demand placed upon it for fuel oil to be burned by vessels several times larger than it has ever had under normal conditions. It is absolutely essential that these vessels, to be operated efficiently, should be supplied with fuel oil, even to the curtailment of industries on land.

Senator STONE. Who wrote that?

Mr. STRONG. One of the fuel administrators. This man, who is president of the corporation, is the head of the Red Cross in that location, and is a man of patriotic impulse and believes that he ought to do the patriotic thing in this matter.

Senator SMOOT. That letter was from the fuel administrator of the State of ———?

Mr. STRONG. Yes, sir. I was endeavoring to keep that out of the record, because this refers to a specific corporation.

Senator SMOOT. As long as you put in the name of the proposition I knew where it was.

Mr. STRONG. You will not object to my eliminating the name from the record?

Senator SMOOT. Oh, no. What I wanted to know was whether it was the local administrator or the national administrator.

Mr. STRONG. I have another case.

Senator SMOOT. I suppose there are hundreds of them?

The CHAIRMAN. You can put that in the record without reading it now if you like.

Mr. STRONG. All right, Mr. Chairman. The necessity for enlarging production in the country imposes upon the industries of the country the requirement of a larger supply of working capital. They must carry larger inventories, prices are higher, their purchases are larger, their turnover is larger, wages are higher, and they need to borrow more money for the commercial turnover.

Senator STONE. Are you speaking of transportation companies now?

Mr. STRONG. I am coming to that, Senator. I believe that the facilities of the Federal reserve banks will be ample to take care of that kind of commerce credit which is necessary to move goods

through the processes of production, manufacture, and marketing, and the credit we extend has been supplemented to some extent by direct advances to those manufacturing for the Government through the War Credits Board. About $150,000,000 in advances I learn have been made, although possibly a more scientific administration of this matter could be conducted through the one agency of this corporation as a part of its activities rather than through a separate bureau of the Government. I have no feeling of concern about the amount of credit available for the purely commercial type of transaction, which brings corporations to the banks for loans. Beyond that, however, existing means of transportation must be enlarged, and provision for enlarging railroad facilities, I understand, is already covered by a bill now pending in Congress which appropriates $500,000,000 for that purpose. Enlarged ocean transportation facilities has been taken care of by the ship-building program with appropriations already made. But that leaves the distinctly industrial and public utility corporations without any specific means of getting capital credit, as distinguished from commercial loans, if the investment market will not extend it, and these are the two large classes of corporations that do urgently require that aid, if you please, because they are now called upon to enlarge their plants and machinery and increase production in order to supply the Government with war materials.

Senator TOWNSEND. Has that proposition of advancing 30 per cent of the contract price met with the approval of the Federal Reserve Board?

Mr. STRONG. Senator, I do not know that they have been directly concerned with that. Of course, it would not reach the direct operations of the reserve banks at all.

Senator TOWNSEND. You have looked into that?

Mr. STRONG. I have discussed it occasionally with some of the men in the Treasury Department and, without having studied it, have a feeling that it is an unsatisfactory way of dealing with the situation.

Senator SMOOT. From the standpoint of the Treasury Department or of the concerns manufacturing the munitions of war?

Mr. STRONG. Of the Government.

Senator SMOOT. That could only be done by a large amount of money being taken out of the Treasury assets. As I understand, when the 30 per cent has been granted it has been placed to their credit immediately. That is the thing the Secretary of the Treasury referred to the other day in his statement before the committee. But I think, myself, it would be very much better to have that advance made by the Government of the United States, to come through one agency rather than to have it divided as it would be under the existing law if this bill became a law.

Mr. STRONG. This bill provides an automatic time and method for winding up which is desirable. It also avoids making direct advances by the Government to corporations that are working for the Government, which is likely to lead to the situation that is sometimes described by the statement that when a debt falls due the lender becomes the servant of the borrower. The Government at the conclusion of the war might find itself in that uncomfortable

position as a result of dealing directly with these manufacturers if the plan to make direct advances was continued.

There is also to be dealt with the whole subject of municipal borrowing, which is a very puzzling and difficult one. The relations to arise between the corporation, if it is created, or whatever agency deals with this matter, and the municipal authorities and the public-service commissions of the various States should be carefully considered. I suppose it is fair to say that the direct intervention of the Federal Government in assuming to control or influence the affairs of municipalities or to influence the control exercised by public-service commissions over the operations of public utilities companies is frequently resented. As I understand the design of this bill and the delared intention of the Secretary of the Treasury in the management of the corporation, agencies which have already been created throughout the Federal Reserve Districts would be employed to deal with the license question—that is, the control or licensing of capital issues, which would include municipal issues as well as issues of public utilities corporations which are subject to the review, and frequently made in response to direct orders, of public-service commissions. I feel that the relationships to be established between the public authorities in the various States and municipalities and the local volunteer organizations now created to supervise issues of securities will work more satisfactorily than if a Government official attempted to deal directly with the municipal authorities and with public-service commissions. I speak somewhat from the standpoint of New York. I believe that a committee of bankers in New York to which the city ordinarily looks for its credit, a representative group of men, would have a better influence with the local authorities in controlling expenditures than would be the case by the application of pressure or influence from Washington. I may be mistaken in that, but that is my view.

Now, I would like to emphasize once more at this point the importance of the license feature of this bill in its direct relation to municipal borrowing. The only method of control legally that I know of is to surround the issue of those securities with restraints that can be applied through the cooperation of the bankers who ordinarily handle them, and I think it is safe to say that bankers generally will comply with the terms of this bill very cheerfully, although it does involve very serious sacrifices to them to abandon or curtail their business, which is what it means if the investment markets remain closed. What is taking place at the present time is a very considerable extension of bank loans and deposits by the borrowings of these corporations that need capital and can not get it except by borrowing from the banks. If, as I apprehend will be the case, this plan operates successfully it will be just as though the Government undertook to indorse the obligations of corporations that needed some indorsement of their credit in order to sell their securities. The Government will put $500,000,000 of capital into this corporation, and as that is exhausted, if it is necessary they will borrow money in the market through the sale of its own obligations. Now, there are many people in this country who do not want to buy or can not afford to buy a long-time 4 per cent bond who would be very glad to buy bonds of this corporation, although the Government did not

guarantee them, because of the feeling of assurance they would have, due to the Government's interest, and I think it would have a strong sentimental effect upon the security market generally. If that is the case and it becomes an instrument for leading investors to cooperate, either by direct purchase of issues of solvent corporations that do not get advances or by the sale of the obligations of this corporation, then the process of expansion of bank loans and deposits will be somewhat arrested or even reversed. Corporations that get the benefit of this market will be able to pay off their bank loans, and that will effect a reduction of both loans and deposits or check their expansion. The deposit account and the loan account will be reduced generally. That is simply another way of stating that the reserve percentage of banks will be increased. At that point many banks may find that they have more loanable funds, and, referring to the provision in the bill which requires that no interference shall be permitted with ordinary commercial borrowing, I think the question is raised as to whether it does not become necessary to effect some control over borrowings from banks that might result from their easier condition as may well be created through the operations of this corporation.

Senator SMOOT. I doubt if there will be any danger from that source, because I do not think the banks dare to take paper to any great extent that can not be used as security to secure credit in the Federal reserve banks.

Mr. STRONG. But they are doing it.

Senator SMOOT. To a certain extent, yes, now; but the pressure has not come upon the banks as it will very shortly for these renewals that you have already spoken of. When they come in there will not be money enough available to take care of them in the banks of the country to do any regular business whatever; so it seems to me there is very little danger from that source.

Mr. STRONG. Senator, the railroads are borrowing very large sums from the banks at the present time. If the bill passes Congress which provides the capital, so to speak, for railroad operations, doubtless those loans will be repaid.

Senator SMOOT. You will find also that many of the obligations the banks are holding of the railroads have been used already in order to secure credit of other banks from the Federal Reserve Board.

Mr. STRONG. We do not take any of those.

Senator SMOOT. Do you not take any of the railroads?

Mr. STRONG. No; we do not hold those. Probably most of them would be quite ineligible, anyway.

Senator SMOOT. Why so?

Mr. STRONG. Well, they do not comply, presumably, with the purposes of the act in requiring that the paper we take shall represent the commercial turnover. Those borrowings represent capital for railroad construction. We have never taken any in the Federal Reserve Bank of New York.

The CHAIRMAN. There is very little of the securities of the large corporations engaged in war work that would be eligible for that use in the Federal reserve banks, is there?

Senator SMOOT. Oh, very little indeed, because under the law they are not allowed to take that class of paper.

Mr. STRONG. No, sir. To determine what is eligible under our system, where corporations borrow on their notes rather than on a bill drawn for the sale of goods, we must examine the statement of the corporation. There is no other way of determining whether a note is eligible than by ascertaining whether the total borrowings are well within the current liquid assets of that corporation, and it might well be that notes, the proceeds of which were actually used for capital purposes, might nevertheless appear to be eligible because the borrower had so large an excess of current assets.

Senator SMOOT. Do you remember what the amount of loans now is of the Federal reserve banks?

Mr. STRONG. Of all 12 of the banks?

Senator SMOOT. Yes; of all the banks.

Mr. STRONG. They have total loans and investments of, in round figures, $1,000,000,000.

Senator SMOOT. I thought it was a little more than that.

Mr. STRONG. A little over $1,000,000,000. That condition (the unwise employment of released credit) to which I referred might not be true of the whole country, but I think in money centers where the greater part of this borrowing is done, if the Government by direct or indirect aid should put these corporations in a position to pay off their bank loans, there would be groups of banks and certain individual banks which would find themselves with larger reserve percentages than they required and naturally operating at a profit they would seek to employ those funds. If they turned around and did the same thing over again—that is, extended credit for construction purposes to what we call generally nonessential industries, and later on those industries applied to this corporation for a license to raise capital, not for contemplated construction work but for construction work which had already been undertaken and contracted for and possibly paid for out of bank loans—the usefulness of the license system would be impaired. I think possibly reliance may have to be placed upon two influences to restrain that. One might be impressing upon the banker the necessity for caution in extending credit to borrowers who might subsequently require licenses for refunding purposes, and where there would be some doubt as to whether they would get the license.

Senator SMOOT. That would be true if we did not know the Government was going to issue billions of obligations in the future. If they were just to take care of the business of the country, without advances to our foreign allies, and the burden placed upon the Government of the United States in obtaining money and conditions were normal, then there is not any doubt that your statement would be correct. But I think the obligation will be so stupendous that there will not be any room for the expansion of the business of the banks.

Mr. STRONG. I would rely more, however, upon another fact, and that is that the Government is organizing agencies for lending money that will sweep idle credit into the Government's coffers as fast as created; but the Government does not pay as much for its loans as many borrowers are willing to pay, and the incentive to profit is a very strong influence upon any bank that for the moment has a surplus reserve.

Senator SMOOT. Before this war is over I think every bank in the United States will have to be assisted in some way by loans from the Federal Reserve Board, if they take care of their regular business; and I do not think the Federal Reserve Board would advance the money if those banks had violated the spirit of this law and advanced money to institutions to carry on just such projects as you have suggested.

Mr. STRONG. That statement leads right up to my point—how can the Federal reserve bank of any district control that extension of credit to any member bank which applies to borrow upon eligible paper without inquiring as to whether the proceeds of the rediscounts of that paper will not be used for some nonessential industries?

Senator SMOOT. That is what they will do, I think. I do not think there is any question about that. Under that bill that is what it says their duties are.

Mr. STRONG. I think that is just the point my remark was leading to. That is a very difficult problem to deal with, and it is exceedingly difficult for the Federal Reserve System to deal with, because while we have in our membership considerably more than one-half of the banking resources of the country, we have less than a third of the banks, and with so many State banks entirely beyond our control there is in effect a leak in the control. That has got to be dealt with in some way. The object of my statement was to express simply the view that if the operation of this corporation should for the moment increase the lending power of any bank or group of banks, or all of the banks, that increased lending power should be directed in such a way that it would promote the war purposes of this Government.

The CHAIRMAN. Mr. Strong, you said that you thought the banks were amply able to take care of what might be called the general commercial business of the country. You have also made a statement about the difficulty of certain industries, especially public utilities and municipal corporations and industries that need large advances in order to expand their plants to supply the demands of the Government for war materials—you have made the statement that they might have difficulty in securing through the banks the funds that they need to carry on their operations in an adequate way. It has been suggested in that connection in these hearings that one of the troubles growing out of that situation was the ineligibility for rediscount in the Federal reserve banks of the paper of these different agencies or instrumentalities, and I think it would be helpful if you would give the committe a clear, concrete statement as to why these securities are not eligible for rediscount. Of course, members of the committee now understand why, but this record is being made up for Members of the Senate who will not hear these statements, and in order that they may have the benefit of a clear exposition by you of the reasons why this paper is not eligible, I think it would be worth your while to spend a little time in putting those reasons in the record.

Mr. STRONG. The principal reasons why obligations taken by banks, made for the purpose of enlarging the production of war industries are not eligible is because they are borrowing for fixed capital expenditures on plant and machinery, and the limitation imposed upon the Federal reserve banks, which is very proper,

requires that the paper they take shall represent the credit employed in the production and marketing of goods where the sale of the goods at the maturity of the paper, if you please, provides the fund to liquidate the paper. We are also not permitted to take paper that matures beyond 90 days. Much of that kind of capital borrowing is beyond six months or a year and would not be eligible anyway on account of the maturity, but in general the character of the borrowing does not conform to the purpose of the Federal reserve act in providing credit for the normal production and movement and marketing of goods. That is essential.

The CHAIRMAN. It is not commercial paper?

Mr. STRONG. It is borrowing money for investment in plant and machinery and real estate and buildings, and so on, which of course is a fixed investment, the notes for which should not normally find their way into a reserve bank for discount.

The CHAIRMAN. And in normal conditions the banks would naturally discriminate against that class of securities?

Mr. STRONG. They would; yes, sir.

The CHAIRMAN. In favor of a class of securities that would be available for rediscount in the banks under the Federal Reserve System?

Mr. STRONG. Yes, sir.

The CHAIRMAN. And that will become more accentuated as the business of the country expands and the necessity of money grows a little bit tighter.

Mr. STRONG. Yes, sir. I stated earlier in my remarks that the resources of the reserve system should be ample to take care of the commercial turnover represented by the eligible paper. Of course, if this country is going to try to conduct a war of this magnitude and finance it and continue the business of the country as usual without any restrictions upon the consumption of luxuries, it merely adds unnecessarily to the burden that would be imposed upon the reserve banks, and it would be very much easier and simpler for us to perform our business if there were a reasonable and proper curtailment of unwise and unnecessary credit through the licensing plan proposed.

Senator SMOOT. Is the Federal Reserve Bank of New York making any loans upon Liberty bonds to the banks?

Mr. STRONG. Yes, sir.

Senator SMOOT. On what basis?

Mr. STRONG. We make two types of loans. One is the discount of the obligation of a customer of a member bank, secured by Liberty bonds. This may run for a maximum period of 90 days. We discount those as member banks require it, and our present rate is 4 per cent. We also advance upon the collateral security of the Government's bonds and certificates of indebtedness for periods not exceeding 15 days, and our rate for that is 3½ per cent, but the notes have to be stamped, and the penalty of the stamp is so severe on short borrowing that that can not be employed very much, certainly not for shorter periods than 15 days. It adds one-half of 1 per cent for 15 days.

Senator SMOOT. And what per cent—95 per cent of the value of the bond?

Mr. STRONG. We loan at par on the certificates of indebtedness and par on Liberty bonds. The loans on bonds that we get are usually those which secure the notes of customers of the banks.

The CHAIRMAN. The reserve banks do loan upon Liberty bonds?

Mr. STRONG. Yes, sir.

The CHAIRMAN. That is, upon the note of the holder of the bonds, secured by the bonds?

Mr. STRONG. Yes, sir; and indorsed by the member bank that presents the notes for discount with us.

Senator SMOOT. In other words, if you had a $100,000 loan it would require as many stamps for 15 days as for 90 days—that is, the Government stamp of 2 cents a hundred?

Mr. STRONG. There is this difference, Senator, that the individual borrower from the member bank who borrows for 90 days does not feel the penalty to be such a heavy one on a note running for 90 days; but in the case of the larger, 15-day borrowings, which are direct loans made to member banks and not to their customers, this stamp tax imposes a very heavy penalty.

Senator SMOOT. It is six times greater?

Mr. STRONG. Yes; it is a serious embarrassment. Senator, you referred to the discrimination taking place between eligible and noneligible loans. That has become a matter of rather serious importance. There is necessarily a discrimination, a desire on the part of banks generally, and particularly of member banks, to maintain a large percentage of their loans in that type of loan which can be discounted with the reserve banks. We get daily reports from the principal banks and trust companies of New York City, and in looking over the reports this morning I find they show that the total of stock-exchange call loans made by the principal New York City banks and trust companies has been reduced one hundred and seventy million since last September, and offsetting that, these same banks report an increase in the amount of their eligible paper of two hundred and seventy millions in the same period. No doubt some part of the additional one hundred million is due to the reduction of other loans that are ineligible but which are not stock-exchange call loans.

Senator SMOOT. In other words, there is not the same amount of business done in daily transactions in stock and bonds as there used to be?

Mr. STRONG. There has been considerable liquidation, Senator, in consequence of this discrimination, and that operates, of course, unfavorably as to all securities.

The CHAIRMAN. It was stated here day before yesterday that the public-utility securities of the country had suffered a very serious slump in the last few months. To what extent is that slump due to this discrimination on the part of banks against that class of securities?

Mr. STRONG. I doubt if it is due very much to that, Senator. I think the principal cause of the lack of confidence in those securities lies in the fact that all the public-utility corporations are feeling very seriously the influence of higher cost of operation without the ability, particularly by those that are controlled by public-service commissions, to correspondingly increase their rates. There is a diminishing margin of profit in the operation of the public-utility corporations.

The CHAIRMAN. That undoubtedly is the prime cause, but I was trying to find out if in your opinion this alleged discrimination

making it more difficult for them to secure accommodations in the banks had anything to do with the dropping in the value of the securities?

Mr. STRONG. I do not think that has had a very strong influence upon the market prices of their securities.

Senator SMOOT. A witness the other day referred to the great decrease occurring in common stock. Of course, that is natural in all corporations whose net income is reduced to such an extent as the income of public utilities of the country are now generally.

Mr. STRONG. Yes, sir.

The CHAIRMAN. Has the stocks perceptibly fallen more than the securities?

Senator SMOOT. Yes; five times as much.

Mr. STRONG. Yes, sir. Some have quite disappeared.

The CHAIRMAN. The stock is more intimately connected with the earnings than the securities?

Mr. STRONG. With the residue of earnings, and when the residue of earnings disappears the value disappears.

I would like to make a statement in regard to one very important feature of this bill, and that is the eligibility of the obligations to be issued by this proposed corporation as collateral loans discounted with the Federal reserve banks, because at that point our direct interest in the matter arises. As you know, it was proposed by the terms of the Calder bill, as it was prepared, to permit the reserve banks to discount notes made by borrowers of banks which are secured by stocks and bonds. At the time my personal view was that that was unwise for a number of reasons. One was that it opened the doors of the reserve banks to a flood of possible borrowing on existing loans. The collateral loans of the banks secured by collateral which are ineligible might in that way be precipitated on the reserve banks too rapidly. Of course, that could be somewhat controlled by a discrimination in rates, but it seemed to me at the time that the approach to the reserve bank was too direct a one. On the other hand, with this discrimination now so general, if the reserve banks are safeguarded against abuse of a widening of the rules of eligibility, it will undoubtedly greatly facilitate the operations of this corporation to have that feature of eligibility attached to the securities to be issued, so that they might be used, if you please, in the event of an emergency rather than as a normal operation of discount. I see by the bill that there has been applied a special tax on so much of the Federal reserve notes as may be issued upon the security of these obligations as collateral. I would like to point out to the committee that I do not think that plan of a tax on Federal reserve notes will operate as a restraint as it should. The tax should apply at the point where the transaction originates. Once the Federal reserve bank has discounted such paper, the special tax will not operate as a restraint at all. The reserve banks are now earning largely in excess of their dividends, and it merely means that a part of the surplus earnings of the reserve banks which go to the Government anyway will be paid to the Government in the form of a note tax instead of as a franchise tax. Furthermore, the tax, unless added to the discount rate, does not reach the borrower, and it is the borrower we should restrain by a tax. The Federal

Reserve Bank of New York last month earned $1,200,000 net, and I have no doubt that this year we may earn as much as $15,000,000 net. The imposition of a tax on our note issue would not operate to restrict the note issue, as much as our own consciousness that it might be unwise to issue notes.

Senator SMOOT. You can do it indirectly by raising the rates.

Mr. STRONG. The best method of controlling the volume of securities of that character would be by a discriminating rate against the borrower, and the application of such a rate, I think, would be most effective, and it would have a very desirable result in another way. No member bank would come to the reserve bank and borrow at the higher rate, which might apply to this paper, in order to get a particular kind of collateral into the reserve banks and out of its own hands, because the borrowing bank is obligated anyway. The tendency of the member bank is to borrow from us at the lowest rate, and I can see as a result of the changes which have taken place in our rates in New York, that the minute one rate goes up the banks transfer their borrowings to those possible at the lower rates. That would be the case here. There is another reason why the tax on the notes of the Federal reserve banks would not be particularly important. The assets of the Federal reserve banks are interchangeable between the banking department and as collateral behind the note issue. With the large volume of business the reserve banks are now doing, and will be doing increasingly, they will have ample collateral of a character that would not be subject to this tax, to pledge for their note issue. They could, if they desired, keep the collateral that subjects the note issue to a special tax in their boxes, and pledge the other kind, but there would be no object in their escaping the tax. As a matter of fact, there is no object in retaining this provision. The tax simply goes to the Government out of a different pocket. I would suggest that the provision that applies to the borrowings of the savings banks would be much more effective in the way of restraint upon the excessive use of our facilities than would any tax on the note issue.

The CHAIRMAN. You said the restraint upon savings banks?

Mr. STRONG. The discriminating rate of 1 per cent.

Senator SMOOT. My thought in reading the bill was that the object the Treasury Department had in providing that was that they would leave it entirely to the boards to decide the rate of interest and they thought they could regulate it by that rate of interest rather than by the provisions provided for in the bill regarding foreign savings banks.

Mr. STRONG. Senator Smoot, I believe the point is completely covered by the terms of the bill as it stands, and that the tax on the notes is simply of no avail and might just as well be left out.

Senator SMOOT. Would you have the power, anyhow, to regulate, without that tax?

Mr. STRONG. The complete power is given for the Federal reserve banks to apply restraint, and they undoubtedly would exercise that power.

Senator LODGE. You think it is quite necessary to give some form of relief to the savings banks?

Mr. STRONG. Yes, sir; I think the provisions of the bill in that respect are admirable.

Senator LODGE. There is a very strong complaint among the savings banks of New England where, as you are aware, of course, the amounts in savings banks are very large.

Mr. STRONG. Yes, sir.

Senator LODGE. The feeling is that the 90 days is not a sufficient protection and that they ought to have some longer time, and the Secretary of the Treasury seemed to have no objection to the extension of the time from 90 days to 6 months or a year.

Mr. STRONG. The only important object that I can see in making it 90 days is the moral influence upon the officers of borrowing banks not to misuse the facilities.

Senator LODGE. The savings banks, of course, as you know better than I, have assets which as a rule are not easily liquidated. They are not quick assets. They are not fluid and can not be quickly dealt with.

Mr. STRONG. They make long-time investments, as a rule, of course.

Senator LODGE. They hold a great many real estate mortgages and things of that sort.

Mr. STRONG. The New England savings banks do buy mill paper, I understand, which gives them some kind of protection.

Senator SMOOT. I see no objection to making it six months or a year in behalf of the savings banks.

Mr. STRONG. I do not believe it is very important. My conviction about this savings-bank provision is that once a means of relief has been afforded and it becomes available there is not going to be any great demand for accommodation by the savings banks. There are two influences that the savings-bank officer fears. One is the possibility of the interruption of the steady inflow of deposits and some withdrawals on account of the Government loans.

Senator SMOOT. That has been already done to a limited extent?

Mr. STRONG. Yes, sir; and the other, of course, is the fear of the influence on the public of the knowledge that the value of their investments has declined materially and may even further decline. Once the savings-bank officers know that there is a place where they can go and borrow money as they need it to meet withdrawals they are going to be reassured to such an extent that confidence will be imparted to the depositors of the savings banks generally, and I regard the value of that sentiment as much greater even than the mere providing of money.

Senator LODGE. The moral effect.

Mr. STRONG. The moral effect will be very important.

Senator SMOOT. That is true as far as the securities of the depositors are concerned; but, for instance, at the next Liberty loan that will be issued the patriotism of the people will be appealed to, and I know that, as far as our savings banks are concerned, even in the last issue of the Liberty bonds there was quite a decrease in the savings banks' deposits for no other purpose than for the purchase of Liberty bonds, and as these bonds are issued in increasing amounts the pressure will be still greater upon citizens to exercise every power to purchase them, and I feel quite sure it is going to affect the savings banks.

Senator LODGE. They have suffered in that way more than from direct withdrawals; they have suffered from the checking of the inflow of the deposits.

Mr. STRONG. That is where I think the influence of the Government loans will be felt increasingly.

Senator STONE. How can you prevent that?

Mr. STRONG. In our district in New York we have discouraged the withdrawal of deposits from savings banks by depositors in order to buy these bonds, but you can not discourage their using money which they have not put in the savings banks, and when you interrupt the regular inflow of deposits the regular withdrawals which are ordinarily made will cause a shrinkage in the deposits automatically.

Regarding the question of eligibility of the paper of this corporation, while in normal times possibly I would be one of the last to encourage any attempt to introduce into the reserve banks obligations of this character issued by any corporation, I do believe it is a wise and necessary provision now, and one of the effects I think will be to insure a better and prompter and wider market for these securities than would otherwise be the case. The volume to reach the reserve banks can be controlled in the extent to which such securities are used for loans by member banks. It gives the whole banking system an added assurance in possessing eligible rather than ineligible paper that they hold a secondary reserve of collateral which they would not ordinarily want to use but for which at times they might be quite willing to pay the penalty of a higher rate in order to borrow on it at the reserve banks. There is a provision in the bill referring to direct advances to industrial corporations and others as "exceptional."

Senator LODGE. Paragraph D.

Mr. STRONG. Yes, sir; as to "exceptional" cases.

Senator LODGE. I should like to hear from you on that, for I think it is a very important provision.

Mr. STRONG. I think any adjective in legislation is liable to encounter difficulties of interpretation, and I am not at all sure that it is wise to attempt to classify normal and exceptional cases by legislation. I do not know just how the purpose of the bill will be accomplished; that is, whether it will be principally directed through the agency of the banks or through direct loans. That is largely a matter of administration. I do not see that it does any good, however, to say "in exceptional cases." A capable administration will determine whether it is exceptional or not and whether exceptional circumstances require some special method of treatment of that case; but it implies a situation that would be very difficult of definition.

Senator LODGE. It opens a pretty wide door.

Senator SMOOT. I think it is the most dangerous part of this whole bill—paragraph D, section 6.

Mr. STRONG. Doubtless, Senator Smoot, occasion would arise for making direct advances, where embarrassment might result if there were no power to make those direct advances. As I stated earlier, the wisest operation of this corporation would result in the advances being coincident with curtailment of credit, and in such a way that some investment market for the interest-bearing obligations of the corporation would be found and as little capital borrowing as possible be forced upon the banks of the country.

Senator SMOOT. I can not conceive of any corporation or firm, or any person who has a legitimate business, and that business is con-

tributory or necessary to the prosecution of the war, that would fail to secure a loan through the regular channels if they had back of them any kind of security whatever, and I do not believe the Government of the United States ought to advance money to any person, firm, or corporation without it has back of it the indorsement of some responsible bank of the country. I think it opens the door wide, and I suppose you have noticed that the requirements under paragraph D of this section are nothing like the other requirements for the savings banks or the banks themselves. There is no question of a value of 75 per cent or 125 per cent deposited as security—no limitation whatever. It seems to me this is a very dangerous and a very loosely drawn provision.

Senator TOWNSEND. Suppose we had one of the public-service corporations that wanted to borrow a large amount of money, and which wanted to refund a large amount of its debt and was unable to get the indorsement of its bank for the reasons you have shown, because of the decrease of its earning power, due entirely to conditions beyond its own control and not through lack of management, it can not go and get this money——

Senator LODGE. The public utilities are classed distinctly by themselves, and can be provided for as such.

Senator TOWNSEND. Senator Smoot's idea was that these all could go through a bank.

Senator SMOOT. I am speaking of the paragraph as drawn. I recognize that in the case of public utilities, where the charges of the corporation are regulated by State law, there should be in such cases some special provision made; but outside of that I know of no case where they ought to get the money in that way.

The CHAIRMAN. This is the position taken by the public utilities before the committee. They said that unless they could get in under this exceptional-case clause this act would afford them very little relief; that is to say, on account of the situation their inability to increase their rates and falling off in their net earnings; that the banks would not accept their collaterals as sufficient security and they would not be able to get loans from the banks, making it necessary for them to go directly to this corporation. Now, they said, "Unless we are permitted to go directly to the corporation we can not go through the banks, and we will not be benefited by the legislation unless we can get in under this paragraph D with reference to exceptional cases." It was suggested here that "exceptional cases" might be so defined as specifically to include the securities of public utility corporations.

Senator LODGE. Is it necessary to go beyond the public utilities? That is the point in my mind. I think it is clear that we must take them in.

Senator SMOOT. The statement that has been made before, and the one made here by Senator Simmons now, on its face shows that the securities of these public utilities are not sufficient to secure money from the regular money market, or, in other words, they are chances that the banks of this country do not want to take, and therefore they want this Government corporation to take those chances that will not be taken by regular lenders of money.

Mr. STRONG. I think there is another very important influence, and that is that the public utilities as well as the railroads are being driven to the banks now to get capital for construction, and they should not be forced to go to the banks; that is not a banking function.

Senator GERRY. Do you think there are other cases outside of the public utility corporations which should have the benefit of the provisions of paragraph D?

Mr. STRONG. I do. I do not think our Government would be advancing $150,000,000 now, principally upon work in processes by contractors, if there was not a necessity for it.

Senator GERRY. Your objection to that paragraph is merely to the use of the word "exceptional"?

Mr. STRONG. Yes; I think that the law as now drawn might imply that the directors of this corporation must classify those corporations that need relief into normal and exceptional cases, and when it comes to exceptional cases that they can be given relief directly, and I do not think any such classification is possible. You might say that the classification is between those who can go to the banks and those that can not. But how are you to establish that fact? Undoubtedly Secretary McAdoo, who has expressed his disapproval of direct Treasury advances, would prefer not to loan $150,000,000 to these Government contractors, but he seems to have been forced to do it because it has been done, and I have no doubt, while I have not discussed it with him, that the reason is because these Government contractors can not get bank credit, and in my view the object of this legislation should be to relieve the banks as much as possible of the present necessity of furnishing capital to the industries of the country. The banks should finance the turnover of the material, and new agencies must be created for supplying this capital if it can not be had from investors directly.

The CHAIRMAN. I understood the public utilities people as admitting that their securities under the conditions that exist now are not of that class that appealed to the banks; that it was a good loan under ordinary circumstances; but they said, "If we had time to deal with the State agencies that regulate our prices we possibly might be able to get them to advance our rates to a point where we could put our business upon a substantial and safe basis; that it is not upon that basis now." They said, "We can not get this money from the banks," and they did not contend that their loans were such as ought to appeal to a safely conducted bank. They said, "We want to be permitted to go to the Government and get the money that we need for the purpose of meeting our maturities; otherwise we have got to go to the wall. Now, we are as essential to the prosecution of the war as these industries that are manufacturing munitions of war. If we can not get money from the banks and the Government will not let us have it, then what are you going to do with us? You are going to drive us to the wall." I understood their appeal to the Government was to help them, although their security might not be of the best character.

Senator THOMAS. In ordinary times they would go to the wall, but the business would not cease. The holders of the securities would foreclose and go on with the business.

The CHAIRMAN. Then they might not be in any better condition.

Senator TOWNSEND. They would not go to the wall in ordinary times—because they are solvent institutions—but for the fact that their costs have increased beyond their rates.

The CHAIRMAN. But that process could not go on without a very great disturbance, and ought not to be tolerated at the present time.

Senator THOMAS. A great many of them are overcapitalized and have issued bonds beyond their power to meet, to pay. That may have a great deal to do with the apprehensions they now entertain.

Senator JONES. Does not the citizen, the investor, the public, realize that there is an advancing cost of labor and materials, etc., and that the cost is liable to increase, and they hesitate now to put their money in long-term securities at the present rate of interest?

Mr. STRONG. That is undoubtedly one influence, Senator. I think to-day the immediate embarrassment of these corporations arises from the fact that they are under the necessity of asking the banks to make loans that the banks ordinarily should not make. These corporations to which I referred earlier in my remarks are in the position of being forced to borrow large sums for short maturities from banks in order to make capital expenditures for extensions of plant.

Senator JONES. At a much higher rate than the rate they are bearing on their bonds.

Mr. STRONG. Certainly at no higher rate than they would have to pay if they attempted to sell bonds; but the restraint that is being imposed upon these corporations is due to this fact, and my own experience as a banker before undertaking my present work convinces me of it: When we were asked to make a loan of the character of some of these loans to a public-utilitles corporation we always wanted to know, in case it was a capital expenditure, how the loan was going to be paid. If the applicant said, "We will have available in a certain period of time securities to be issued and sold to the public and to our stockholders," and frequently that they already had a contract with responsible bankers for the marketing of those securities, then we had no hesitation in advancing large sums of money for this temporary capital requirement, having the assurance that there was a market for the securities and that there were bankers who were willing to buy them and that our loan would be liquidated within a reasonable time. At the present time no public-utility corporation can give the banks such assurances, because the bankers will not underwrite such securities and the public will not take them.

Senator JONES. Why will not the public take them? Why will not the public take the renewals?

Mr. STRONG. The principal reason is that most of the investor's money is being swept into the Government coffers by the liberty loans, and another reason is that war conditions create timidity in the minds of investors and many will not buy securities at any price. Most of them will not even buy at a very tempting rate of interest. Some industrial corporations, I understand from their statements, are earning many times their interest charges, and yet their securities are selling on the most attractive interest bases we have ever seen in this country.

Senator LODGE. Is there not also another reason? By the State laws they are absolutely confined in their rates, and their expenses have gone up enormously, but they can not raise their rates. The industrial corporation can raise its prices to meet increased expenses, but public utilities can not. That puts them in a class by themselves.

Mr. STRONG. There is a constantly diminishing margin of profit of all corporations subject to the State rate-making power.

Senator LODGE. If they could raise their rates in accordance with their expenses, they would be all right?

Mr. STRONG. Yes, sir; they would have a very much better market for their securities.

Senator SMOOT. I noticed the other day that one very prominent public-service corporation is offering 7 per cent preferred stock at 80 cents on the dollar.

Senator TOWNSEND. In many cases they can not do that. Under the law they have to sell them at par.

Senator SMOOT. That is one of the largest public-utility corporations in the United States.

Senator JONES. Then, perhaps, the most important factor is the timidity of the public, the fact that the public is not willing to put ordinary investment funds into permanent investments?

Mr. STRONG. Yes, sir; that plays a very important part.

Senator LODGE. But that applies to all investments. But there is a special trouble with the public-utilities corporations, because they can not raise their rates. They can not raise the price of the commodity they furnish, and other corporations can.

Senator SMOOT. I understand that over one-third of the stock brokers of the country have gradually closed out their business.

The CHAIRMAN. I understand they have got about two hundred and thirty millions falling due in a month or six weeks.

Senator LODGE. That is renewals. They have the same difficulty there.

The CHAIRMAN. Suppose some such plan for enabling them to get the money to meet their maturities or sell the securities they want to put on the market is not devised, would not a very serious situation be precipitated when those securities matured?

Mr. STRONG. Undoubtedly. It is a matter that is daily approaching a forced solution one way or the other.

The CHAIRMAN. Did I understand you to suggest that instead of retaining the exceptional case provision in section 6, clause D, that we ought to segregate the public utilities and put them in a class by themselves?

Mr. STRONG. No, sir.

The CHAIRMAN. And provide that they may borrow direct from this corporation and not through the banks.

Mr. STRONG. No, sir. I think the provision of the bill in section D is about as it should be, except for the necessity of ascertaining which are and which are not exceptional cases. I believe that direct advances to essential industries, which might include public-utilities corporations, will be found necessary. They have already been found necessary to the extent of a hundred and fifty million dollars, and will probably increasingly be necessary. One important reason for this

legislation and one of the principal objects served by the Government aiding corporations is to prevent the congestion of capital advances in the banks. The increase in that class of loans to corporations should be curtailed to the minimum; if every manufacturer that needs additional capital who is working on a Government contract must get a bank's indorsement of his loan from this corporation, it will simply accelerate expanding bank loans for capital purposes. This corporation, making advances, wisely should be able to market a considerable amount of its securities, and should be able to do so as a result of restricting the market to the absorption of securities necessary for the war, directly or indirectly.

Senator SMOOT. The money will have to come from some source, whether it is issued directly to the corporation or the firm or the person, or whether it is issued through the banks. There will be no more inflation in one case than there is in the other; and it seems to me that if we now take out the word "exceptional" it will mean in all cases—that is, to make advances directly to any person. It gives a power there so great that they can advance it to almost anybody or any corporation they desire, for any kind of a scheme. Pressure could be brought to bear, political or otherwise, that would be dangerous, it seems to me, under the provisions of this paragraph.

Senator THOMAS. Would not that apply equally to the loans of banks?

Senator SMOOT. No; because the bank has got to indorse it, and that means they will be responsible for it.

Senator LODGE. That means there will be securities behind it.

Senator THOMAS. What reason is there for the board to deal more leniently than an outside institution?

Senator SMOOT. It will mean that they can not get the security in any other way, and all the pressure that can be brought to bear is going to be brought to bear on this board.

Senator LODGE. For dubious investments.

Senator THOMAS. That will be done anyhow.

Senator SMOOT. But it will have to be done through a bank.

Senator LODGE. The fundamental difference is that the banks are lending their own money and that people in the corporation are lending the Government's money.

Senator THOMAS. My impression is that if you pass this bill you have got to make some such provision with regard to such interests as are covered by this section.

Senator SMOOT. If that is the case, why have the other paragraph at all? Let everybody come here; let everybody go direct.

The CHAIRMAN. Mr. Strong, you wanted to make an additional statement?

Mr. STRONG. I feel that the application of the principle which Senator Smoot has in mind would result in this situation: The Government is asking contractors to increase their plants and produce more goods for war purposes. Those plants need more capital. The Government says, "You must get a bank to indorse your paper before we will furnish you with capital"; and where some of these contractors may not manage their businesses prudently they might fail, and the Government would be in the position of having saddled

upon certain unfortunate banks the burden of such losses, which should fall upon everybody through taxation.

Senator SMOOT. But the Government is authorized now to issue 30 per cent of the contract, and all of the manufacturing concerns I know of are well satisfied with that proposition.

Mr. STRONG. That is for work in process.

Senator SMOOT. And, not only that, the Government of the United States has in certain cases issued millions of dollars of credits for putting up plants.

Mr. STRONG. Yes; I understand there were some such cases.

The CHAIRMAN. Do you or not think the banks are willing to take that risk because of the profit that they will make?

Mr. STRONG. I think the banks are doing that to the extent of their ability now.

The CHAIRMAN. It is true that the banks might occasionally lose on account of making loans to these industries, but the question I was asking was if there was any hardship on the banks in view of the fact that the profits would be very large, and would it not be entirely satisfactory to the banks to take that little minimum of liability in order to get the profit?

Senator THOMAS. The hardship is either way. You make the man pay the profit both to the Government and to the intermediary, which is the bank.

The CHAIRMAN. I do not see it that way.

Senator THOMAS. Suppose a public-uitlity corporation came to this board and presented an extraordinary case. You refer them to the bank; you say, "Do it with the bank." The bank is not going to do it for nothing; it is going to make its charge, and it is perfectly proper that it should.

Senator STONE. Mr. Chairman, Mr. Strong is making a very interesting and instructive statement, and I am afraid he will not be able to complete it. Are you going on until he completes it?

The CHAIRMAN. I would like to go ahead for a while. Mr. Strong, how long will it take you to finish?

Mr. STRONG. Only a few minutes, Senator.

The CHAIRMAN. Then, we will continue. I am perfectly willing myself and I think it would be wise to let the public utilities, because of the conditions that have been disclosed, borrow directly from the corporation, but I do not think it would be wise to permit everybody and anybody to borrow from the corporation, because I think that the fact that the borrower must go to the bank is a very great safeguard against the corporation making unwise and injudicious loans. The banks are in close touch with the borrowers everywhere; the corporation would not be, and I think it is a very wise thing to have the banks stand in between the Government and the borrower in order to safeguard the class of securities on which the Government would make advances.

Senator JONES. But would you permit the different branches of the Government which are now making direct advances to munitions factories, and so on, to continue that operation, or would it not be better to bring that into this corporation?

The CHAIRMAN. This is intended to be a substitute for that.

Senator LODGE. I think it is a question of more exact definition. I do not believe that exceptional provision is of any use.

The CHAIRMAN. I was under the impression that the wise course for us to pursue to meet that situation would be to define exceptional cases, to declare that a certain class of industries might go directly to the corporation. For instance, public-utilities corporations might be permitted, on account of well-recognized conditions that they are laboring under, instead of going to the corporation through the intermediary of the bank, go directly to the corporation.

Mr. STRONG. It seems to me the principle sought to be applied by that argument is a wrong one. The public-utilities corporations undoubtedly need the assistance. They can get better credit if they are fairly treated in rates. If they get better credit they will be able to do more financing. But here is the Government calling upon manufacturers to increase their plants and facilities for production of war materials, and at the same time it makes these enormous demands upon these industries it says, "We will not lend you money directly; you must find a bank to indorse you," and those industries will have to go to the banks. The principle, it seems to me, should be that the Government should furnish the indorsements to the bank by the means of this corporation, and if any of those contractors should fail it merely means that the added cost is distributed by taxes over the entire country, and it is not entirely borne by some unfortunate bank that has been induced from patriotic or other motives to provide an indorsement.

The CHAIRMAN. That would change the whole theory of the bill.

Senator GERRY. Would there not be less of those failures if the banks made examinations instead of this corporation, because, as the chairman said, are not the banks a great deal more familiar with the business men in their own communities than a national corporation would be?

Mr. STRONG. That familiarity with the affairs of the specific borrowers would certainly be greater in the case of the banks, but the undesirability of a bank furnishing capital to industries that are working on Government contracts is the restraining influence at the present time in getting credit at banks.

Senator SMOOT. The advances that have already been made by the Government for that purpose have been in nearly all cases to corporations that are now in existence. They are well known by people all over the country, by every banker in the United States; they are well known by the Government officials. It is only a question of the ability of the bank to make these advances. I can cite you to a number of cases where the banks felt absolutely hopeless in advancing money, taking into consideration the capital and the surplus of those institutions, but the Government is perfectly willing to advance them 30 per cent of the contract price. They are doing it. It is not interfering at all with the credit at the banks; I mean the running credit. I believe that those cases are being taken care of under the existing law to-day, and in cases of that kind we could specifically state the cases, cases where they were making munitions of war for the Government, but do not leave the provision open as it is.

Mr. STRONG. The specification of a direct Government contractor would cover a fairly narrow field of industry. If you specify the Government contractor or those furnishing power and supplies to

Government contractors, you will cover a very wide field of industries.

Senator SMOOT. "Public utilities" would cover all such institutions. I do not know of a hydroelectric plant that is not furnishing to some city its light under the direct control of the public service commission of the city.

Mr. STRONG. I would also include furnishing materials.

Senator LODGE. You said that "exceptional" was a difficult word to define, that you were rather distrustful of adjectives, in which I quite agree. Is it not possible for the committee to get some more exact definition. Do you not think that would be more desirable, so as to leave no doubt about the adjective?

Mr. STRONG. Certainly the main purpose of this bill, aside from the general relief to corporations that have obligations maturing, is to enable the Government's contractors to enlarge their facilities for the production of munitions and other essential things for war purposes. I would very much regret to see the authority to make direct advances eliminated from this bill. I think it will be found to be necessary.

The CHAIRMAN. If this bill should become a law, I take it, that if any corporation having a contract with the Government for war supplies should not be able to secure a loan through the banks, it still could obtain advances from the Government, just as it is now obtaining them; this, while to an extent a substitute, would not remove the present power of the Government to aid in a case of that sort, where they could not get relief through the operation of the bill. That takes care, therefore, of the man who is contracting with the Government. These public-utility corporations are not contracting with the Government. They do not go after money in order to carry out a Government contract. They are not on a parity with the others in that respect, or in any other respect. The war-contracting corporation to a large extent fixes its prices; at least it has no rigid limitation placed upon its prices. But the public-utilities corporation, by the regulation of the States in which they operate, can not increase their rates one cent, while their operating costs advance enormously, and their net receipts are reduced to a minimum; so much so that they can not go to the banks and get the banks to help them. Now, the Government can not help them through the Treasury, and they have no way of getting help except by going directly to this corporation. If you are not going to let them in under the exceptional clause, you have got to let them in under a specific clause permitting the Government to extend a loan directly to them, as it can not do otherwise.

We will give you permission, Mr. Strong, to put in the record any additional statement which you wish to make.

Mr. STRONG. The situation of the company referred to in my statement is briefly as follows:

The capital requirement of the company for the year 1918 is estimated to be $15,687,000, of which $5,687,000 consists of outstanding bills payable owing by the company, and $8,047,000, an issue of bonds due May 1, to which must be added various sinking fund payments and proposed construction expenditures for the fiscal year.

The company and its subsidiaries serves many industries in the territory which it covers, and is furnishing supplies either directly or indirectly to the

Government, the production of the various districts covered by the company's operations, including supplies being shipped to the Government, orders to the War Department, to the aeroplane engineering departments, Engineer Departments, Signal Corps, arsenals, etc. In one of its districts, it estimates that between 130 and 140 important consumers are interested in a greater or less degree, directly or indirectly, in Government contracts, where requirements for electric power and light for the year 1918 amounting to approximately 90,000,000 killowat-hour will be utilized in the furnishing of supplies, directly or indirectly, to the Government, and in the manufacture of war orders and essential parts thereof.

In addition, a subsidiary of the company is furnishing gas for industrial purposes to many manufacturing companies having war contracts, doing Government work, or producing essential supplies for those who have direct Government war orders. This subsidiary, which manufactures gas, renders service in six large industrial centers, and the amount of gas sold for industrial use forms a large portion of the total output of the company. Other subsidiaries of the company, operating in other sections, are estimated to be furnishing at least 50 industries engaged in whole or in part upon orders for the Government with electric power. these industries estimated to have a connected load in excess of 18,000 horsepower in electric motors, which will require a supply of upward of 20,000,000 killowat-hour.

Traction lines owned by the company are now engaged in furnishing transportation service to two National Army cantonments.

This compay, which has outstanding bonds and notes aggregating over $84,500,000, has found it necessary to entirely discontinue payments of dividends at the rate of 6 per cent per annum on over $18,000,000 of preferred stock, notwithstanding that its earnings are much in excess of the amount required for that purpose.

The statement above made is an abstract from a written statement made to me by the vice president of the company, and further particulars and information will be furnished if desired. The name of the company, as well as the names in the letters quoted from in my statement relating to the operations of two other companies have been purposely omitted in order that no inconvenience may be caused as a result of their becoming public.

One of the chief difficulties of the present situation is to find a method by which the large amount of obligations of corporations maturing in the near future may be handled without throwing the burden entirely upon the proposed war-finance corporation.

It is fair to assume that the establishment of this means of relief will create an atmosphere of greater confidence than now prevails and that uniform direction, under the guidance of the management of this corporation, of the efforts of corporation managers to arrange for extensions of their maturing obligations by present holders will enable them to place new securities with present holders for a large amount of this maturing debt. The licensing system will exert pressure upon corporations dealing with so-called nonessentials to reduce maturing indebtedness by the conservation of their assets and the application in greater degree of current earnings to the reduction of debt rather than to enlargement of plant and production. Plans along this line all lead to economy in the use of labor and material and again will facilitate the Government in obtaining its war requirements.

Attention does not seem to have been called to the fact that many investors always prefer investments which mature in the near future and investors of this class are even more insistent upon short-time investments in time of war than in time of peace. The securities of this corporation having behind them a large amount of unpledged

assets and the corporation having $500,000,000 of capital furnished by the Government will appeal strongly to investors who desire short obligations maturing in from, say, one to five years at somewhat higher rates than the Government's long-time bonds and, in time, there should be a wide market for them without necessarily interfering with the Government's long-time operations.

The bill provides that four of the directors of the corporation shall be selected by the Secretary of the Treasury with the approval of the President and may be removed by him with the President's approval. This is in line with the recognized necessity in time of war to centralize authority, holding those in authority responsible for the successful discharge of their duties. I believe that the method provided will insure more promptly the selection of capable directors and the successful operation of the corporation than other methods that might be suggested. It will promote prompt decisions and progress. On the other hand, the provision that no director or officer of the corporation shall continue to be an officer, director, or trustee of any other corporation or a member in any firm of bankers is an unwise restriction which will unnecessarily interfere with the appointment of the best qualified directors. The operations of this corporation will require the services of men who are at the present time active in affairs rather than those who have severed their direct contact with business affairs or have had no such contact in a large way. It would seem wiser to remove this restriction and rely upon a wise choice in the selection of men who are both competent enough and honest enough to discharge their duties without any regard to personal interest and this I am confident is possible.

The country is gradually coming to understand that to the extent that the savings of the American people are not sufficient to finance the war it must be financed by the employment of bank credit and expansion. The first duty of our Government is to bring about by influence, education, and, if necessary, by absolute control, the necessary economy in the use of material, labor, and credit so as to enable the financing of the war to be conducted with the least possible employment of bank expansion.

But the need for bank expansion, and, possibly, a large expansion, during the period when effective control of the consumption of materials and the employment of labor and credit is being developed must be recognized and dealt with courageously. Behind our banking system is the greatest store of gold reserve ever held by any one nation in the world's history. If we must vastly expand bank loans and deposits upon the base of this gold reserve because our people are not yet economizing to the degree which they should, it is our first duty to see that the methods employed to furnish the Government with credit through bank expansion are those which will result in the least financial and economic disturbance when the period of liquidation comes after the war. Then the expansion will be along safe lines.

The proposed corporation, under competent management, will afford much protection to the banking system, as it will enable a wise control of the amount of assistance required of the Federal reserve banks, will insure their receiving for their advances of this character the obligations of banks on all paper discounted by the Federal

reserve banks, will furnish collateral in the form of the bonds of this corporation, which collateral will, in turn, be secured by a large volume of assets of the corporation free of mortgage or pledge, with a margin of $500,000,000 of capital paid in by the Government. The provision for the termination of the activities of the corporation shortly after the conclusion of the war, and the winding up of its affairs, assures an automatic and orderly liquidation of this expansion to the extent that, and as soon as, it becomes necessary and possible.

In general, I believe the design of the bill is vastly better than direct Government aid by congressional appropriation, and is much sounder and safer than the direct employment of the assets of the reserve banks. To some extent, and possibly to a very large extent, it will relieve the commercial banks of the country from the necessity of furnishing large credits for capital purposes to industrial and public-utility corporations, as its operations should bring about a greater confidence in the security markets and the return of a more willing attitude by investors to purchase securities for permanent investment.

In connection with the proposed legislation, consideration should be given to the interests of the investment bankers of the country whose businesses have already been seriously affected by war conditions, and might, in fact, be completely destroyed if the financing of all private enterprises was undertaken by the War Finance Corporation as a Government agency. It would appear that the reassurance resulting from the establishment and operation of this corporation by an orderly licensing of issues which are found to be desirable in the interest of the war and by the withholding of licenses from those found to be undesirable will result in many corporations finding it possible to sell securities and get necessary accommodation in the market through the normal channel of investment bankers. The War Finance Corporation will thereby be relieved of some part of the burden which it might otherwise be obliged to assume and will assist in preserving a normal, rather than in creating an abnormal, condition in the investment market.

The CHAIRMAN. If that is all, the committee will now adjourn.

(Thereupon, at 12.06 o'clock p. m., the committee adjourned, to meet at 10 o'clock a. m. to-morrow, Friday, February 15.)

ESTABLISHMENT OF A WAR FINANCE CORPORATION.

FRIDAY, FEBRUARY 15, 1918.

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to adjournment, in the committee room, Capitol, at 10 o'clock a. m., Senator F. M. Simmons (chairman), presiding.

Present: Senators Simmons, Stone, Thomas, Jones, Gerry, Lodge, McCumber, Smoot, Gallinger, and Townsend.

The CHAIRMAN. Mr. Lyford, please state your full name, your residence, and whom you are here representing.

STATEMENT OF MR. JAMES O. LYFORD, CHAIRMAN OF THE BANK COMMISSION OF NEW HAMPSHIRE.

Mr. LYFORD. I am chairman of the bank commission of New Hampshire, and I speak for the bank commissioners of the New England and middle States.

The CHAIRMAN. We do not have bank commissioners in my State, and I wish you would in a general way describe their functions.

Mr. LYFORD. In the States that I have referred to the bank commissioners have supervision of the banking institutions outside of national banks, the State institutions. In the States I am speaking of, New England and New York, New Jersey, Pennsylvania, Delaware, and Maryland, the savings-bank interest is larger than the State bank and in some cases the national-bank interest. The bank commissioners of these States have supervision of banking institutions, see that the laws in regard to investments are enforced, see that the officers make investments in accordance with law and have general direction under the statute of the financial institutions of the State.

The CHAIRMAN. Supervisory powers?

Mr. LYFORD. Yes, sir.

Senator SMOOT. Are they elected or appointed?

Mr. LYFORD. They are appointed. The bank commissioners of New England and the middle States have had two meetings since the first Liberty loan, with a view of getting such information as they could from one another as to conditions in their several States and taking, if necessary, any joint action. At the last meeting we drew up recommendations to the Secretary of the Treasury, two recommendations: First, we urged him, if it were possible, to keep the next Liberty loan at 4 per cent by giving it some attractive features that would enable it to sell at par. That I need not go into

because I understand that is a matter entirely within his discretion; second, that we have legislation in this war finance corporation bill that would enable the savings banks to borrow to meet withdrawals of their depositors. That recommendation appears in the bill. The general feature of it we indorse. There are two principal points we would make. One is that the loans should be for more than 90 days, and the other is that the rate of interest should be left in the discretion of the board, as the rates for all other advances are left.

The CHAIRMAN. You say you think the time ought to be extended so as to allow more than 90 days. What time would you suggest?

Mr. LYFORD. Really the time should be unlimited, as I will explain, perhaps, as I go along. The point is here, the credits we have are not liquid, the savings-banks credits. They are long-time investments; they are mortgage loans to a large extent. In New York 50 per cent are in mortgage loans.

Senator STONE. Real estate mortgages?

Mr. LYFORD. Real estate mortgages.

Senator SMOOT. You do not mean unlimited. You would certainly want some limitation, because this corporation is going out of existence after the war.

Mr. LYFORD. Leave the time of making these loans with the directors of the corporation.

Senator SMOOT. I am perfectly willing to give all the time that is necessary, but I would not want to leave it open. I would want the law to specifically state it; if six months, all right, and if a year, all right. I think a year would be sufficient, because if not taken up in that time and you want the loans to continue there is no doubt you could have renewals.

Senator STONE. What would be the expense of a renewal?

Senator SMOOT. Two cents on a hundred.

Mr. LYFORD. I do not think we differ on that. The point is, the loans must be made for the period of the war, because there will be no appreciation of savings-banks securities after the war, and whether you make it for a year with the opportunity to renew or for the period of the war is immaterial. The point is that there shall be power somewhere with the board to extend these if you limit the time to a year, as they will have to be extended.

Senator SMOOT. That power is granted in the bill now.

Mr. LYFORD. Is it granted?

Senator SMOOT. Specifically, no; it does not say that there shall be renewals, but there is not a thing in the bill that prevents the savings banks from making renewals.

The CHAIRMAN. Nobody has questioned up to this time the right of the board to make renewals. I think the Secretary of the Treasury in his testimony frequently spoke about the ability of borrowers to secure renewals. I suppose you might trust their discretion to grant renewals whenever the circumstances were such as to entitle you to further credits.

Senator SMOOT. I hardly think there is any question in the minds of Senators but that there shall be time granted to the savings banks for loans for a longer period than specified in this bill, and even the Secretary of the Treasury said he was perfectly willing that it be made a year

Mr. LAFFERTY. Then that would be entirely satisfactory. I think it should be made a year if you are going to limit it, because it would give the savings banks time to go ahead to do what they will have to do. The interests involved here are very large. I do not think it is appreciated outside of these States how large the interests are. The mutual savings banks exist principally in New England and the Middle States. The amount of their deposits is $4,500,000,000. The amount of all kinds of deposits, both individual and time deposits, certificates of deposit, cashiers' checks, United States and postal savings deposits in the national banks of those same States is $4,065,000,000, the savings deposits in those States exceeding the deposits in the national banks of those States by $500,000,000. Outside of those States the mutual savings banks exist in a few other States, and their total deposits are only $170,000,000. There are stock savings banks in other sections of the country, trust companies, and State banks that take savings deposits, and the aggregate of those deposits in those stock companies is something like a billion dollars. These savings-bank deposits average in this territoroy a little less than $500 each. There are eight million and a half depositors in this section, in New England and the Middle States. These depositors, as you may see from the average deposit, are wage earners or clerks on salaries; they are individuals who lay aside something, farmers, and others. They represent the small legacies or insurance that is left to the wife and the children which is put in the savings banks because they can go there any time and withdraw what they need; or, if it is sufficient, they can live on the income of it.

Now, this money is invested largely in real estate loans and long-term bonds. You could not collect real estate loans, because the parties are not prepared to pay them, and then there would be no place that they could borrow to repay them. The bonds are for 10 or 20 years. The accounts are only active in normal times as an individual has occasion to use his savings deposit in a case of emergency. These deposits come in with regularity; in normal times it is not necessary for the savings banks to keep a large cash deposit on hand for the reason that the new deposits, the maturities of loans, or the maturities of bonds, will more than take care of the withdrawals.

The history of these banks shows that there has been a constant increase of these deposits. There is absolutely no profit to anybody except the depositors in these mutual savings banks. Whatever is earned over and above expenses and taxes belongs to the depositors' accounts. The only salaries are those paid to the president, the treasurer, and the clerks. The trustees either work for nothing from a philanthropic spirit, or they have a nominal compensation of from $1 to $5 a meeting that they attend. They are usually successful business men in the community who virtually give their time to the investment of these deposits and to the care of them.

Very few of the savings banks take commercial paper. They do not have to, for the reason that I have explained. They benefit the local communities; the loans that are made to the business men of the community are two-name paper, or notes secured by collateral, and are made with the expectation that the loan will be continued as long as the business man desires it, provided he promptly pays his interest, and his credit remains good. We could not call local

loans without an embarrassment to local business—throwing men out of employment—and the amount of these loans outside of the mortgage loans is comparatively small. Therefore, we are in a situation during this war period where it is necessary for us to meet the withdrawals of depositors. The withdrawals in the first and second Liberty loan were taken care of with some borrowings, but mostly because the banks prepared themselves for it.

Senator STONE. Who did you borrow from?

Mr. LYFORD. From the national banks, and if they had some paper which could be rediscounted, they borrowed of the national banks, and the national banks rediscounted that paper at the Federal reserve banks; but if they did not have very much of that they had to borrow by putting up bonds. Of course, the national bank must have liquid assets, and the same is true of the Federal reserve banks.

Now, they have reached about the limit of meeting these withdrawals. I do not mean that they could not go along for a little time and by such maturities as came in and by their interest payments meet the withdrawals, but we have lost in the several States from 3 to 5 per cent of the deposits; that is, they shrank that amount.

Senator SMOOT. During the last Liberty loan?

Mr. LYFORD. During the six months following June 30 until the beginning of this year.

The CHAIRMAN. In normal times, what is your increase?

Mr. LYFORD. I can tell you particularly with reference to New Hampshire. We lost last year $2,600,000. Our normal increase the year before was $7,000,000, the year before $6,000,000. So that in normal times we would have increased three and one-half millions in the six months, but instead of that we lost $2,600,000.

Senator TOWNSEND. Really $5,000,000.

Mr. LYFORD. Really lost $6,000,000, and our losses are relatively the same in proportion as those in other States. I think perhaps Maine lost more than any other State.

Senator TOWNSEND. What rate of interest do you pay?

Mr. LYFORD. From 3 to 4 per cent. We have some in our State paying 3 per cent, some 3½ per cent, but the bulk of them pay 4 per cent. About half of the banks of Maine pay 3½ per cent.

Perhaps you will understand this class of securities if I explain to you what rate we get on New Hampshire's securities, and that will represent relatively the same for other States. In our State we loan on real estate mortgages at 5 per cent, and if we loan at 5 per cent that mortgage may be reckoned as an exemption from taxation of the savings banks' deposits. We pay a tax of three-fourths of 1 per cent on the average amount of deposits for the year. Under the deductions that can be made from that amount are the amounts invested in real estate mortgages in New Hampshire, the amounts invested in municipal bonds in New Hampshire that do not bear a higher rate than 5 per cent, United States bonds, and the bonds of the Federal Farm Loan Bank. Those two last exemptions were put in by the last legislature at my request.

Senator TOWNSEND. What proportion of your money is loaned in New Hampshire?

Mr. LYFORD. We have $126,000,000 in the mutual savings banks of New Hampshire, and nearly $50,000,000, in round numbers, is

loaned in New Hampshire. In New Hampshire the savings banks accumulations are more than three times the assessed value of all the railroad property of the State, nearly three times the value of all its manufacturing plants, equal to nearly half the total value of the improved and unimproved land and buildings of the States, and these savings accumulations are more than one-quarter of the equalized valuation of all the property of the State as assessed for taxation.

I presume that other of the New England and Middle States could show the same relation of savings deposits to other property of those States. This gives you an idea of the magnitude of these savings deposits and their importance financially and industrially.

Of the $126,000,000 of accumulations of the savings banks of New Hampshire nearly $50,000,000 are loaned or invested in the State; nearly $26,000,000 are loaned on real estate mortgages at a rate not exceeding 5 per cent. Thirteen millions are loaned to the business interests of the State, loans that could not be collected without disastrous results to business and employment. One million dollars is loaned to New Hampshire municipalities at a low rate of interest, besides the amount invested in the bonds of these municipalities. These bonds bear interest rates of from 3 to 4 per cent. Another $10,000,000 is invested in securities of New Hampshire industrial and transportation companies, and in the bonds of cities, towns, and districts of the State. These investments within the State would be larger if our demands were larger.

Seventy-six millions of our accumulations, or three-fifths, are invested in other States and contribute to the growth and prosperity of those States. In round numbers $17,000,000 are loaned to farmers of the West and South at an average rate to the savings banks of not over 5½ per cent. Eleven millions are invested in municipal bonds, of which amount probably $8,000,000 are in municipal bonds of the West and South. Thirty-three millions are invested in railroad securities, of which amount probably one-half are in the securities of railroads west of the Mississippi and south of the Potomac. Eleven millions are invested in the securities of public utilities, of which amount probably one-third is invested in the securities of public utilities of the West and South. Nearly $3,000,000 are invested in the stock of manufacturing companies of New England and other States.

In some respects our investment laws for savings banks are more liberal than those of the other New England and the Middle States. Vermont loans a larger amount than we do on farm mortgages of the West and South. In all the other New England and Middle States it is necessary to go outside the State to make their investments.

Senator STONE. Did you say the municipal bonds that you had taken from New Hampshire towns bore 3 per cent?

Mr. LYFORD. From 3 to 4 per cent.

Senator STONE. And how much interest do you pay?

Mr. LYFORD. We pay 4 per cent.

Senator STONE. And invest it first in 3 per cent bonds?

Mr. LYFORD. We get 5 per cent net on all State mortgages, 6 per cent on all personal and collateral loans, and an average of 5 per cent on our western loans, and I should say that the bonds taken as a whole might net a little over 4 per cent. The expenses of these

institutions are small. The tax is three-fourths of 1 per cent, with the exemption of no tax on real-estate mortgages within the State and municipal bonds within the State. Rates were very low with us a number of years ago, and our savings banks, as well as the savings banks of the other New England States and the Middle States, took bonds of municipalities. We have bonds of western and southern municipalities that only net us 4 or 4½ per cent. We have got very few 5 per cent bonds from the State and the West at the present time.

Senator SMOOT. Is there not another reason why you carry those 3 per cent bonds, and that is if at any time you are called upon for ready money they are the quickest assets, the best that you could liquidate, to meet the call?

Mr. LYFORD. Yes; in normal times, Senator, the bonds are available for borrowing money at the banks. For instance, if we had a local run, as we sometimes do, upon a savings bank, or two or three savings banks—because a good many of our people are foreigners and get frightened—we would take those bonds to Boston and borrow the money. But the situation to-day is such that we can not borrow; they are not quick assets.

The CHAIRMAN. Your rate, as I understand, averages about 5 per cent; you loan on a basis of something like 5 per cent?

Mr. LYFORD. You mean the returns of the savings banks?

The CHAIRMAN. Yes. The question I want to ask is: What is the rate charged for commercial paper and the amounts carried by the national banks and the State banks?

Mr. LYFORD. Five and six per cent. Mr. Thorndike, the commissioner from Massachusetts, can tell you probably the rate they receive there. There are a few savings banks that are in larger centers that dare to take commercial paper. They get about 5 to 6 per cent.

Senator SMOOT. Is there any special provision in this bill that you wanted to speak of to-day and which you desired to have amended?

Mr. LYFORD. Yes; I would say just three features. One is what we have discussed—the time in which the loans should be made; and if you put a time limit on it, it should be a year with the understanding that if the war is not over then that it could be renewed. I think the provision of the bill that says that the rate of interest shall not be less than one per cent in excess of the prevailing rate of discount at the Federal reserve banks is penalizing the savings banks. Certainly they ought to be able to borrow on the same charges, or to get advances from this corporation that would be given to a munitions plant or a profit-making plant. The mutual savings banks make no profit for anybody but the depositors; everything they have belongs to the depositors after paying their expenses and taxes.

Senator SMOOT. Would not the 1 per cent cover all the expense attached to the mutual savings banks or the savings banks of the country, over and above the rate at which they get the money from the corporation?

Mr. LYFORD. No; for this reason: they are paying, none of them, to any appreciable extent, more than 4 per cent; the average is less than 4 per cent. If they have to pay not less than 1 per cent in excess of the discount rate every time that they borrow they might be paying 1 or 2 or 3 per cent more than what they get.

Senator SMOOT. I think you put a wrong construction on that section, if that is your idea.

Mr. LYFORD. It is my idea.

Senator SMOOT. Perhaps you had better make your statement, and after you get through I will call your attention to it.

Mr. LYFORD. We are perfectly content to leave this rate to be fixed by the board of this corporation. If you have confidence in them, and you have confidence in them in allowing them to fix the rate for any advances they make to money-making corporations, why should you put any limit on the rate to savings banks; why not strike that out? We have got to go to this board and ask for advances and we are willing to take our chances on their fixing the rate.

The CHAIRMAN. I suppose you will not resort to this means of getting advances except in an emergency. The purpose is to make this an emergency accommodation.

Mr. LYFORD. Exactly, Mr. Chairman, and if you make it I hope we will have to go to it but very little because the very fact that we can do it will strengthen the confidence of the savings banks. I will say in reply to that, that I have urged upon our savings banks that in meeting this next Liberty loan they go as far as they can, not only to buy Liberty bonds to sell them to their depositors and others, as they did in the last loan, but also to purchase all that they can hold as an investment, and in that way help the Government. These people who have been urged to subscribe for Liberty loans and pay $1 or $2 a week have been pretty well combed out in the New England States, and the advances for these next Liberty loans must come from people who have a little larger income, and we expect losses from the savings; we expect withdrawals. We ask this relief so that we can meet those withdrawals, and we ask that if you fix the time it shall be at least a year, with the opportunity to renew, and that we shall not be up against a provision in the law that compels us to pay 1 per cent in excess of the rate of discount at the Federal reserve bank, because we have got to go to this corporation, to their directors, to ask for these advances. We have the confidence that when we present our situation they will meet it. Therefore I think that provision should be stricken out of the bill.

The CHAIRMAN. If you had to pay no more than you would have to pay if you secured your money through a commercial bank, it would not be an emergency arrangement; there would not be any more inducement for you to pay that obligation off quickly than there would be if you dealt with an ordinary bank. Now, it is not only to the interest of the Government to have you resort to this means of procuring funds only in case of an emergency, but it is also to the interest of the Government to have you liquidate that loan as quickly as possible. That is part of the emergency scheme.

Mr. LYFORD. Let me say in reply to that that it is one of the things that a savings bank naturally resorts to in the last instance to borrow money, and they want to pay those loans just as soon as they can.

The CHAIRMAN. The point I am making is that if the interest is a little higher than the normal interest of banks there will be an inducement always to liquidate that obligation as soon as possible, and

there will also be a reason why you should not resort to this means of securing money except under compulsion.

Mr. LYFORD. Are you not willing to leave that to the rules of the board of directors of this corporation?

The CHAIRMAN. We are leaving that to them, with a certain limitation.

Senator SMOOT. I do not see how you can make anything by leaving it to the rules of the corporation. It seems to me you can not ask any more favors from the corporation than from the regular banking institutions of the country as affecting the rates of money that should be charged by the corporation to the borrower. This provides that the rate of interest charged for any advance to your savings banks "shall not be less than one per centum in excess of the rate of discount for ninety-day commercial paper prevailing at the time of such advance at the Federal reserve bank of the district in which the borrowing institution is located." You are placed upon the same footing as any other bank that comes to this corporation to borrow money. It is true that the savings bank has got to run its chances under this provision of commercial paper being higher at any particular time than the rate they are paying, but this is an emergency matter, and it seems to me that if the banks are compelled to go there, and the situation of the money market is such in the United States that the rate on 90-day paper is higher than the rate you are charging, the Government can do nothing more nor less than say you must pay the prevailing rate.

Mr. LYFORD. That is true; but you penalize us by 1 per cent more.

Senator SMOOT. And so will they penalize the banks. This corporation will have to make that difference to pay expenses.

Mr. LYFORD. The other banks are money-making institutions.

Senator STONE. I would like to ask a question there: You speak of other banks as money-making institutions and the savings banks as nonmoney-making institutions?

Mr. LYFORD. Yes, sir.

Senator STONE. You say whatever the profits of the business in the savings banks may be, they go to the accounts of the depositors, whereas the profits of the bank go to the stockholders?

Mr. LYFORD. Yes.

Senator STONE. That some way strikes me as a sort of distinction without a difference.

Senator THOMAS. It would be in your State and mine, but not in New England.

Senator TOWNSEND. You simply have your depositors there; you have 1,000, or a great many thousands, stockholders in your banks. They own the money. In the other case you have 50 stockholders or 100 stockholders.

Mr. LYFORD. Who make a profit out of the deposits of the other people. Now, you have in some States trust companies and stock-savings banks that take savings deposits and pay a certain rate of interest, and all that the money earns over and above that rate of interest goes to the stockholders. That is the distinction.

Now, let me say this: The savings-banks depositors are a very sensitive class of people. It does not take a great deal to start a panic among them. We have had them, on the slightest pretext,

come to the savings banks and demand their money. Then you must be in a position to pay out their money, and show that you can pay it out. When they learn that you can pay it back they will bring their money back again.

Senator THOMAS. They do not want it if they know they can get it?

Mr. LYFORD. They do not want it when they are sure they can get it. Our situation is this: You close a few savings banks because they can not meet the demands of their depositors, and the run will not stop with those banks; it will not stop at State lines.

Senator SMOOT. You do not mean to say savings banks under this provision would allow a run to continue and the bank to be closed up for 1 per cent on the amount of money they could borrow? That is all this provides.

Mr. LYFORD. Well, I know; but that is a penalty; you are penalizing the mutual savings banks.

Senator SMOOT. I do not want that to go unchallenged, because we are not penalizing the savings banks any more than we are penalizing other banks that come to the corporation to borrow money. They do not get their money at the same rate on 90-day commercial paper. They have got to pay the prevailing rate plus whatever the board decides to charge. With reference to the savings banks, we say we will treat you just the same as the other banks, and we will allow you to have the rate of 90-day commercial paper in the district in which your bank is located, but not less than 1 per cent above that rate shall be charged for what money is advanced to the savings banks. That is not penalizing you. That 1 per cent is simply to pay the expenses attached to this corporation, and I should think you would not object to that being done, particularly from the fact that you will only ask for this money in emergency cases when you must have it.

Mr. LYFORD. We shall not ask for the money unless we are absolutely compelled to go to the bank for it, but it may be that the withdrawals will be such that we will be compelled to go there.

Now, I have tried, but I do not know that I have succeeded, to make clear the distinction between the mutual savings banks and the stock savings banks. The officers of a mutual savings bank are trustees, they are called trustees instead of directors. They get no compensation, only a nominal compensation for their services. They take care of this money, and whatever is made belongs to the depositors themselves; and I do think that there ought to be a distinction made between the mutual savings banks and stock banks that are in business to make profits.

Senator SMOOT. In other words, you want the Government of the United States to guarantee to the mutual savings banks of the country that if they get in trouble and have to go to this corporation to borrow money they shall not be compelled to pay any more than they are charging on the notes they are holding?

Mr. LYFORD. That is what we would like; we would leave it to the board. If the board, under their rules, think we should pay more, all right; but the board is bound by this law.

Senator SMOOT. If I were interested in a savings bank I would rather have this provision in than out.

Mr. LYFORD. Well, they had not.

Senator STONE. You spoke of the trustees of mutual savings banks donating their services at a merely nominal compensation. I want to know if it is true that the trustees, as a rule, are large depositors.

Mr. LYFORD. I do not think they are large depositors, as a rule.

Senator LODGE. In your State, as in mine, the deposit is absolutely limited.

Mr. LYFORD. It is not limited in our State, but it is in Massachusetts.

Senator LODGE. It is limited to $1,500, and under those conditions no capitalist could go in.

Mr. LYFORD. No capitalist goes in. The trustees are men of means, but they do not have large deposits. The average deposit in our State is less than $500.

Senator MCCUMBER. Because of the fact that you loan money at a lower rate of interest than an ordinary bank, you want this corporation to make you a lower rate of interest?

Mr. LYFORD. Yes, sir. I do not ask that you do not charge us more, but I ask that the board of directors have the authority in that bill to deal with us as our merits deserve.

Senator MCCUMBER. On the same principle you would have this corporation charge a much greater rate of interest in those States where the rate of interest is considerably higher than in New York or in the New England States?

Mr. LYFORD. I do not know that you could do that. I am not speaking of what you would have to do in the commercial banks.

Senator SMOOT. In the savings banks of the West we are making loans at a higher rate than you are. Do you then think they ought to be loaned money by the Government at a lower rate than they are actually loaning their own money?

Mr. LYFORD. Your savings banks of the West are on the same par as your national banks. They take savings deposits and invest them for the purpose of making money for the stockholders, and they can invest in more liquid assets, and they do. But take our trust companies in the State of New Hampshire; any trust company—we have not a great many—that takes savings-banks deposits, under the law must keep them as savings deposits and segregate the assets and conduct the department as a separate department, and that department is amenable to the laws governing the savings banks of the State, and if they were to close out they would have to pay the savings-bank depositors out of their assets first.

Senator TOWNSEND. Do you favor the Government loaning you money at less than it costs the Government?

Mr. LYFORD. I only want the bill to provide that the board of directors of this corporation may deal with us according to our merits. I do not want the mutual savings banks to be put at a greater disadvantage than they ought to be. We are entirely willing to put ourselves in the hands of this board. We have got to go and ask them for the advance. We want the time which the committee seems willing to grant. Now, then, if you could provide in that bill that the rate for mutual savings banks shall be in the discretion of the board of directors, that will satisfy us.

I would like to speak of one other point, although I do not care to lay very much stress on it. You require 125 per cent collateral for

any loan. We have got bonds that we could put up, like municipal bonds, that would not require 125 per cent in order to protect the Government. It seems to me that is a matter that might be left with the board.

Senator SMOOT. We give the savings banks 5 per cent, just as for the other banks of the country, in the amount of collateral we require.

Mr. LYFORD. I do not lay any particular stress on that point. There may be an instance of a savings bank that would put up collateral that would be nearly 95 cents on the dollar, even in these times.

Senator THOMAS. You have some collateral that would not be as valuable as that?

Mr. LYFORD. Oh, yes. We could not allow the savings banks to sell railroad and some municipal bonds at the present price and leave the depositors who stayed in unprotected.

Senator SMOOT. It would bankrupt most of them.

Mr. LYFORD. You would be surprised at the situation. I recently made an examination of a New Hampshire savings bank which is one of the strongest banks in the State. We made a joint examination with the officers of the bank. The committee took the valuations of February, and they showed that they had a premium of $1,100,000; that those securties were worth that much more than what they stood on the books. I figured the valuation as of December 1 of that year, and it wiped out that $1,100,000 and $400,000 in addition.

Senator STONE. You mean during that period from February to December?

Mr. LYFORD. I mean the valuations in February and December.

Senator SMOOT. The year 1917?

Mr. LYFORD. Yes, sir.

Senator SMOOT. There was one other point you desired to discuss in this bill. What was that?

Mr. LYFORD. Only in regard to the amount of collateral.

Senator JONES. Do I understand that there should be some different method of dealing with the mutual savings banks and other savings banks?

Mr. LYFORD. A difference in dealing with mutual savings banks and the stock banks that make a profit for their stockholders out of their deposits. The mutual savings bank is largely confined to the New England and Middle States. I do not know whether you were present, Senator, when I spoke of that, but the accumulations of the mutual savings banks of New England and the Middle States are $4,500,000,000. The accumulations of all the other savings banks of the country outside of this territory amount to only $170,000,000. The trust companies and stock savings banks invest their money to make money for their stockholders, while all the money that is made in the mutual savings banks over and above expenses goes to the depositors.

Senator JONES. Do these mutual savings banks operate differently from the other savings banks?

Mr. LYFORD. Yes.

Senator JONES. In what respect?

Mr. LYFORD. Their investments are limited by law, usually to high-grade investments. Most of them invest in local real estate

to a large amount. The other classes of securities they can invest in are prescribed by law.

Senator JONES. How do they divide the profits and the earnings?

Mr. LYFORD. They divide once or twice a year; they have semiannual or annual dividends. At the end of the year they figure out what the profits have been, charge in any loss or shrinkage that there may have been, and pay their expenses and the tax on their deposits, and then they declare a dividend—3 per cent, 3½ per cent, or 4 per cent. If there is any left over, it goes into the surplus.

Senator JONES. How do you arrive at the amount each individual shall receive?

Mr. LYFORD. It is averaged.

Senator JONES. On the deposits?

Mr. LYFORD. On the average deposits for the year. It takes close figuring; it generally takes several weeks' work in large banks, because a great many of the accounts are active. Of course, they have no trouble in figuring the dividends where the deposits have not been disturbed, but where there have been deposits and withdrawals they have to go through and average that up.

Senator JONES. Then, the only real difference is that you are limited by law in regard to your loans—the nature of the securities which you may handle?

Mr. LYFORD. They receive a lower rate of interest than a stock savings bank or a national bank or a trust company.

Senator TOWNSEND. The deposits in the bank and the rate of interest brings the dividend to about 7 per cent?

Mr. LYFORD. Oh, no; you are in error there. The dividend is what they get—the semiannual or annual dividend that is declared.

Senator TOWNSEND. That is what you mean by interest?

Mr. LYFORD. Yes; that is what I mean by interest.

Senator TOWNSEND. You pay 3½ per cent; that includes the dividend?

Mr. LYFORD. That is the dividend; yes. Perhaps I misled you as to that.

Senator TOWNSEND. I understood you to say you paid 3, 3½, and 4 per cent interest, and then the Senator from New Mexico asked what you did with your earnings, and you said you declared a dividend twice a year. Interest and dividends are synonymous?

Mr. LYFORD. Yes; I intend to speak of dividends. I probably misled the Senator.

The CHAIRMAN. Is there any other gentleman who desires to make a statement?

STATEMENT OF MR. AUGUSTUS L. THORNDIKE, BANK COMMISSIONER OF MASSACHUSETTS.

Mr. THORNDIKE. Mr. Chairman and gentlemen, I do not wish to go over the same ground that the bank commissioner of New Hampshire has covered.

Senator LODGE. What are the total deposits in the savings banks of Massachusetts?

Mr. THORNDIKE. One billion one hundred and thirteen million, and the savings deposits in the trust companies—the departments

there have to be run in the same manner as the savings banks—amount to $66,000,000. Of that aggregate of nearly $1,200,000,000 $500,000,000 are invested in trust mortgages and real estate in Massachusetts. Then about $250,000,000 are invested in railroad bonds and street railway bonds. The street railway bonds are confined to the street railways of Massachusetts, but the railroad bonds cover the trust mortgage bonds of any standard railroad—that is, a railroad that is large enough to be called a railroad, which must be at least 500 miles long.

Senator SMOOT. Are those mutual banks?

Mr. THORNDIKE. Mutual savings banks. Those bonds must have been seasoned by having paid 4 per cent dividends for 10 consecutive years before they are legal investments for the Massachusetts Savings banks.

Senator SMOOT. Do they tax you on Massachusetts real estate mortgages?

Mr. THORNDIKE. No.

Senator SMOOT. On the street railroad bonds?

Mr. THORNDIKE. Yes; and on the other bonds. These deposits belong to 2,800,000 accounts. In round numbers, I would say three-fifths of every man, woman, and child in Massachusetts are owners of savings-bank accounts.

Senator LODGE. And the population is about 3,800,000.

Mr. THORNDIKE. That is the importance of our savings banks in Massachusetts. We have a very stringent provision that savings banks shall have no creditors except for rent and salaries, the ordinary expenses of running the savings bank, and they are only permitted to borrow money to pay depositors.

Senator STONE. Are these depositors made up in large part of wage earners?

Mr. THORNDIKE. Yes. The limit of deposit is $1,000, and they leave their accumulations on deposit for years without withdrawing their dividends. We do not call it interest. The accumulation may not exceed $2,000.

Senator STONE. In any one bank?

Mr. THORNDIKE. In any one bank.

Senator STONE. The same man could deposit in other banks?

Mr. THORNDIKE. In separate banks; but the savings banks have recently been rather conservative; they want only the people in their own localities.

Senator STONE. I wanted to get your judgment, if you can not definitely state the fact, about what are the average deposits of the people designated as wage earners in the Massachusetts savings banks?

Mr. THORNDIKE. The average of all the deposits is $481. Now, I should say that the large deposits of $1,000 or more do not amount to one-tenth of the whole assets of the bank.

Senator STONE. They are not more than one-tenth?

Mr. THORNDIKE. Not more than one-tenth. And there are thousands and thousands of deposits that run from $50 to $75. They are almost uncountable. We have two savings banks in Boston that have over 100,000 depositors, and their average deposits in those banks are probably $250.

Senator STONE. Are large numbers of these depositors children, minors?

Mr. THORNDIKE. Yes, sir.

Senator STONE. And women?

Mr. THORNDIKE. It is a fad in Massachusetts for a child to start a savings bank account.

Senator STONE. A very good thing, too. But are women who are engaged in minor employment pretty largely represented in these banks?

Mr. THORNDIKE. Very largely.

Senator LODGE. The great mass of the depositors are the working people of Massachusetts.

Mr. THORNDIKE. Probably the largest savings bank in New England is the Provident Institution for the Town of Boston, which is chartered and which has a preamble stating that it is for the care and improvement of the savings of persons of humble means for their use and their needs.

Senator LODGE. How old is that?

Mr. THORNDIKE. One hundred and one years old. That bank has $59,000,000 in reserve, and they have 150,000 deposits, and every servant girl that lives in the neighborhood in Boston goes to the Provident Bank because they say it is sound. I do not believe they go very much elsewhere. We have another called the Suffolk Savings Bank for Seamen and Others; we have another called the Boston Penny Savings Bank, and we have another called the Boston Five-cent Savings Bank. They used to take deposits as small as 5 cents. Of course now, as the country has grown more wealthy, they do not take deposits of less than $1.

A few years ago deposits which had not been disturbed for 30 years, in which there had been neither withdrawals nor deposits, were turned over to the use of the Commonwealth; but in no case does the depositor or his descendant lose his right to claim that. There were 35,000 of those deposits, and the amount turned over to the State was $150,000; that is an average of a little less than $3 apiece. They were advertised in the papers, and there were whole columns of names in some of our local papers of deposits of $1. I can not tell the number of books, but two-thirds of the books of the depositors contained deposits of $1. Quite a number of the descendants of the depositors have claimed their deposits, and those are being redeemed even now. These are purely the savings of the people, who must have their money for their common needs and their desires when they want it, and although the savings banks may require 90 days' notice there has been no such requirement in Massachusetts for a third of a century, and one of the safeguards of the savings bank system in our territory is that they can put their money in a safe place and get it when they want it.

I will say this, that the income of our savings banks, the amount that they pay out to their depositors in dividends, is about $40,000,000 a year; that is, their combined earnings. About one-eighth of that, before the dividends are distributed, have to go to a guaranty fund, and the rest is then distributed. The ordinary growth of our savings banks is from fifteen to twenty-five millions a year. In 1916 the growth of new money deposited in the savings banks was about $34,000,000. In 1917 of the dividends which were declared, amount-

ing to about $40,000,000, about $24,000,000 remained in the banks and $16,000,000 was withdrawn, and all of the new deposits which had been put in before June had been withdrawn. After the first installment of the second liberty loan was paid the savings banks sent me a statement which showed that $9,000,000 had been withdrawn from the savings banks at that time.

The savings banks have invested one thirty-fifth of their reserve in Liberty bonds. They have $30,000,000 in Liberty bonds, and anticipating withdrawals and subscriptions to Liberty bonds, they have invested in collateral notes at the market rate of interest for the sheer purpose of keeping themselves liquid so they can call on their notes to pay their depositors. Thirty-two of our savings banks—we have practically 200; there are 196—we will say one-eighth, had to borrow, to get the permission of the bank commissioner to borrow money to pay their depositors. Those 22 savings banks in December had to borrow practically $2,000,000, a very much less sum than I thought they would have to borrow. It is not quite three months since most of the borrowings, and they have begun, and from day to day have continued, to notify the commissioner that they had repaid so much of their borrowings, or the whole of their borrowings; and about one-third have been able to recover themselves, to pay up their borrowings within the three months. So, the 90-day limit there seems too short a limit.

Senator SMOOT. A year is long enough.

Mr. THORNDIKE. If it was understood that they could borrow for a year with the understanding that if the exigency arose they could get renewals——

Senator SMOOT. We could not put that in the law.

Mr. THORNDIKE. I mean if it was understood; but it seems to me a year is short enough. There are nearly 200 savings banks in the State, and they have an average of about 15 members each on their boards of trustees—3,000 men— and those 3,000 men deem it an honor to be a trustee of a savings bank. There are no vacancies; the honor is sought. There is no compensation except for work actually performed, and when I say that in 100 years there have been but 22 failures of the savings banks it seems that they have been well managed, and the trustees themselves would have a feeling—I know a great many of them personally and know how they feel—that they would not want to be borrowers of money. There has been no attempt upon the part of savings banks in the six years that I have been administering the banking department to borrow at a low rate and lend at a high rate. There is no inducement for profit to themselves, because the profit goes entirely to the owners of the bank, who are the common people of Massachusetts.

Senator GALLINGER. Approximately, what is the regular dividend paid in the Boston savings banks—the average?

Mr. THORNDIKE. By far the larger number of savings banks pay 4 per cent, I should say seven-eighths of them. Some of the other eighth have paid 3 per cent and some have paid 3½ per cent. For 100 years the conservative investments of our banks have made a 10 per cent surplus, and when that surplus is reached a dividend is declared, and that system seems to have worked out very well.

Senator JONES. I wanted to bring out the point as to how you managed your surplus and how large it was permitted to grow.

Mr. THORNDIKE. When it reaches 10¼ per cent an extra dividend must be declared. There can be no arbitrary bookkeeping entries; the reports of the bank must show the amounts invested in each class of securities, so there is no covering up to hide concealed assets, because there are none. The statements represent exactly the conditions of the bank.

Senator SMOOT. Can you remember what were the average dividends to the depositors or owners of the banks for a number of years back, taking into consideration not only the regular 4 per cent dividends but the dividend that has been paid out of the guaranty fund?

Mr. THORNDIKE. About five banks a year declare an extra dividend. There is one bank in Boston, the Chelsea Savings Bank, with which Senator Lodge is familiar, which has invested in small mortgages and is paying 6 per cent, and about every three years their surplus fund reaches the point where they have to pay one-half of 1 per cent dividend.

Senator SMOOT. That would be 1⅔ per cent extra?

Mr. THORNDIKE. Yes. Five hundred million dollars invested in mortgages represents 120,000 different mortgages on Massachusetts real estate. Of late years the savings banks have not taken great mortgages, but have confined themselves more to the smaller real estate holdings, and I should say that the average mortgage of most of the savings banks would be about $3,000 or $4,000. This particular savings bank—the Provident Bank, that the servant girls use—has taken large mortgages, and their average consists of mortgages of over $50,000, but the other banks take small mortgages.

This system has built up Massachusetts, and we feel that the people, when they want their money, should have the assurance that they will get it, and that it should be supplied by this corporation on terms that would not be a burden to them. Mr. Lyford spoke about the 1 per cent above the average rate for commercial paper. It seems to me that that is rather penalizing our savings banks. If the rate could be left to the discretion of the board and then it was necessary to charge that 1 per cent, that would be all right, but to have the law specifically state that it shall not be less than 1 per cent rather would lead people to think there was something wrong with our savings banks, because they would have to borrow money at a rate higher than the prevailing rate.

Senator JONES. If you had to pay a high rate of interest, that would reduce the dividends to your depositors and in an increasing ratio induce withdrawals, would it not?

Mr. THORNDIKE. Yes; it would.

Senator SMOOT. That same principle is expressed in the law creating the Federal Reserve Board, so it is not a new question at all, nor is it a reflection upon the savings banks.

Mr. THORNDIKE. I believe that is all I have to say, as I would have to repeat what Mr. Lyford said if I went any further.

The CHAIRMAN. Are there any other gentlemen who desire to be heard on savings banks? If not, we will adjourn. Gentlemen, we are very much obliged to you for giving us the benefit of your views about this matter.

(Thereupon, at 11.30 o'clock a. m., the committee adjourned to meet at 10 o'clock a. m., Monday, February 18, 1918.)

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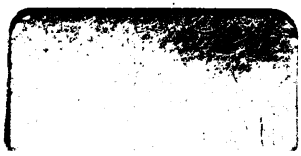

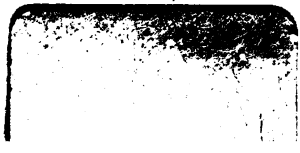

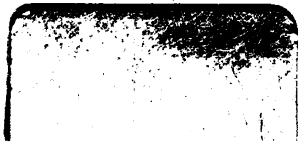

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